Extra Space Storage Inc.
Form 10-Q
November 05, 2010
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2010

or

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

For the transition period from to .

Commission File Number: 001-32269

EXTRA SPACE STORAGE INC.

(Exact name of registrant as specified in its charter)

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

2795 East Cottonwood Parkway, Suite 400

Salt Lake City, Utah 84121

(Address of principal executive offices)

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

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

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

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

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

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

The number of shares outstanding of the registrant s common stock, par value $0.01 per share, as of October 29, 2010 was 87,546,587.

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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:

- adverse changes in general economic conditions, the real estate industry and 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;
- difficulties in our ability to evaluate, finance, complete and integrate acquisitions and developments successfully and to lease up those properties, which could adversely affect our profitability;
- potential liability for uninsured losses and environmental contamination;
- the impact of the regulatory environment as well as national, state, and local laws and regulations including, without limitation, those governing real estate investment trusts (REITS), which could increase our expenses and reduce our cash available for distribution;

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

- increased interest rates and operating costs;

- reductions in asset valuations and related impairment charges;

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

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

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

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

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

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

Extra Space Storage Inc.

Condensed Consolidated Balance Sheets

(amounts in thousands, except share data)

	September 30, 2010 (unaudited)	December 31, 2009
Assets:		
Real estate assets:		
Net operating real estate assets	$ 1,873,161	$ 2,015,432
Real estate under development	29,537	34,427
Net real estate assets	1,902,698	2,049,859
Investments in real estate ventures	144,121	130,449
Cash and cash equivalents	21,798	131,950
Restricted cash	32,893	39,208
Receivables from related parties and affiliated real estate joint ventures	24,593	5,114
Other assets, net	49,047	50,976
Total assets	$ 2,175,150	$ 2,407,556
Liabilities, Noncontrolling Interests and Equity:		
Notes payable	$ 851,812	$ 1,099,593
Notes payable to trusts	119,590	119,590
Exchangeable senior notes	87,663	87,663
Discount on exchangeable senior notes	(2,633)	(3,869)
Lines of credit	115,000	100,000
Accounts payable and accrued expenses	37,445	33,386
Other liabilities	32,241	24,974
Total liabilities	1,241,118	1,461,337
Commitments and contingencies		
Equity:		
Extra Space Storage Inc. stockholders equity:		
Preferred stock, $0.01 par value, 50,000,000 shares authorized, no shares issued or outstanding		
Common stock, $0.01 par value, 300,000,000 shares authorized, 87,545,312 and 86,721,841 shares issued and outstanding at September 30, 2010 and December 31, 2009, respectively	875	867
Paid-in capital	1,146,903	1,138,243
Accumulated other comprehensive deficit	(8,530)	(1,056)
Accumulated deficit	(262,666)	(253,875)
Total Extra Space Storage Inc. stockholders equity	876,582	884,179
	29,701	29,886

Noncontrolling interest represented by Preferred Operating Partnership units, net of $100,000 note receivable				
Noncontrolling interests in Operating Partnership		26,608		31,381
Other noncontrolling interests		1,141		773
Total noncontrolling interests and equity		934,032		946,219
Total liabilities, noncontrolling interests and equity	$	2,175,150	$	2,407,556

See accompanying notes to unaudited condensed consolidated financial statements.

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Extra Space Storage Inc.

Condensed Consolidated Statements of Operations

(amounts in thousands, except share data)

(unaudited)

	Three months ended September 30,		Nine months ended September 30,	
	2010	2009	2010	2009
Revenues:				
Property rental	$ 59,332	$ 60,380	$ 172,261	$ 178,494
Management and franchise fees	5,851	5,191	17,056	15,685
Tenant reinsurance	6,796	5,542	19,026	15,246
Total revenues	71,979	71,113	208,343	209,425
Expenses:				
Property operations	21,334	23,022	64,231	67,456
Tenant reinsurance	1,736	1,264	4,416	3,996
Unrecovered development and acquisition costs	211	22	423	18,905
Loss on sublease	2,000		2,000	
Severance costs				1,400
General and administrative	10,618	9,791	32,903	30,994
Depreciation and amortization	12,519	13,797	37,140	39,160
Total expenses	48,418	47,896	141,113	161,911
Income from operations	23,561	23,217	67,230	47,514
Interest expense	(15,702)	(17,697)	(49,209)	(49,308)
Non-cash interest expense related to amortization of discount on exchangeable senior notes	(416)	(430)	(1,236)	(1,834)
Interest income	178	245	714	1,098
Interest income on note receivable from Preferred Operating Partnership unit holder	1,213	1,213	3,638	3,638
Gain on repurchase of exchangeable senior notes				27,576
Income before equity in earnings of real estate ventures and income tax expense	8,834	6,548	21,137	28,684
Equity in earnings of real estate ventures	1,736	1,752	4,796	5,288
Income tax expense	(1,088)	(726)	(3,347)	(2,317)
Net income	9,482	7,574	22,586	31,655
Net income allocated to Preferred Operating Partnership noncontrolling interests	(1,524)	(1,506)	(4,510)	(4,681)
Net income allocated to Operating Partnership and other noncontrolling interests	(291)	(101)	(661)	(929)
Net income attributable to common stockholders	$ 7,667	$ 5,967	$ 17,415	$ 26,045
Net income per common share				
Basic	$ 0.09	$ 0.07	$ 0.20	$ 0.30
Diluted	$ 0.09	$ 0.07	$ 0.20	$ 0.30

Weighted average number of shares				
Basic	87,484,731	86,437,877	87,244,161	86,260,442
Diluted	92,189,852	91,548,984	91,969,869	91,321,503
Cash dividends paid per common share	$ 0.10	$	$ 0.30	$ 0.25

See accompanying notes to unaudited condensed consolidated financial statements.

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Extra Space Storage Inc.

Condensed Consolidated Statement of Equity

(amounts in thousands, except share data)

(unaudited)

	Noncontrolling Interests			Extra Space Storage Inc. Stockholders Equity					
	Preferred Operating Partnership	Operating Partnership	Other	Shares	Par Value	Paid-in Capital	Accumulated Other Comprehensive Deficit	Accumulated Deficit	Total Equity
Balances at December 31, 2009	$ 29,886	$ 31,381	$ 773	86,721,841	$ 867	$ 1,138,243	$ (1,056)	$ (253,875)	$ 946,219
Issuance of common stock upon the exercise of options				442,990	4	5,097			5,101
Restricted stock grants issued				442,330	4				4
Restricted stock grants cancelled				(61,849)					
Compensation expense related to stock-based awards						3,457			3,457
Deconsolidation of noncontrolling interests			104						104
Redemption of Operating Partnership units for cash		(4,116)							(4,116)
Investments from other noncontrolling interests			87						87
Purchase of noncontrolling interest			223						223
Comprehensive income:									
Net income (loss)	4,510	707	(46)					17,415	22,586
Change in fair value of interest rate swap	(85)	(303)					(7,474)		(7,862)
Total comprehensive income									14,724
Tax effect from vesting of restricted stock grants and stock option exercises						995			995
Tax effect from contribution of property to Taxable REIT Subsidiary						(889)			(889)
Distributions to Operating Partnership units held by noncontrolling interests	(4,610)	(1,061)							(5,671)
Dividends paid on common stock at $0.30 per share								(26,206)	(26,206)
Balances at September 30, 2010	$ 29,701	$ 26,608	$ 1,141	87,545,312	$ 875	$ 1,146,903	$ (8,530)	$ (262,666)	$ 934,032

See accompanying notes to unaudited condensed consolidated financial statements.

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Extra Space Storage Inc.

Condensed Consolidated Statements of Cash Flows

(amounts in thousands)

(unaudited)

	Nine months ended September 30, 2010	Nine months ended September 30, 2009
Cash flows from operating activities:		
Net income	$ 22,586	$ 31,655
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	37,140	39,160
Amortization of deferred financing costs	3,323	2,978
Non-cash interest expense related to amortization of discount on exchangeable senior notes	1,236	1,834
Gain on repurchase of exchangeable senior notes		(27,576)
Compensation expense related to stock-based awards	3,457	2,952
Non-cash unrecovered development and acquisition costs		18,905
Loss on sublease	2,000	
Severance costs		1,400
Distributions from real estate ventures in excess of earnings	4,830	4,665
Changes in operating assets and liabilities:		
Receivables from related parties and affiliated real estate joint ventures	(1,237)	(10,610)
Other assets	(2,162)	(3,934)
Accounts payable and accrued expenses	2,059	4,176
Other liabilities	1,498	487
Net cash provided by operating activities	74,730	66,092
Cash flows from investing activities:		
Acquisition of real estate assets	(24,648)	(27,378)
Development and construction of real estate assets	(28,523)	(57,905)
Proceeds from sale of properties to joint venture (Note 4)	15,750	4,652
Investments in real estate ventures	(9,371)	(2,535)
Return of investment in real estate ventures	7,432	
Change in restricted cash	6,315	(3,395)
Purchase of equipment and fixtures	(1,450)	(799)
Net cash used in investing activities	(34,495)	(87,360)
Cash flows from financing activities:		
Repurchase of exchangeable senior notes		(80,853)
Proceeds from notes payable and lines of credit	131,124	382,879
Principal payments on notes payable and lines of credit	(248,032)	(207,981)
Deferred financing costs	(2,674)	(6,697)
Investments from other noncontrolling interests	87	
Redemption of Operating Partnership units held by noncontrolling interest	(4,116)	(1,908)
Net proceeds from exercise of stock options	5,101	
Dividends paid on common stock	(26,206)	(21,526)
Distributions to noncontrolling interests in Operating Partnership	(5,671)	(5,626)
Net cash provided by (used in) financing activities	(150,387)	58,288
Net increase (decrease) in cash and cash equivalents	(110,152)	37,020
Cash and cash equivalents, beginning of the period	131,950	63,972

Cash and cash equivalents, end of the period	$	21,798	$	100,992

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

	Nine months ended September 30,			
	2010		2009	
Supplemental schedule of cash flow information				
Interest paid, net of amounts capitalized	$	45,593	$	46,006
Supplemental schedule of noncash investing and financing activities:				
Deconsolidation of joint ventures due to application of Accounting Standards Codification 810:				
Real estate assets, net	$	(42,739)	$	
Investments in real estate ventures		404		
Receivables from related parties and affiliated real estate joint ventures		21,142		
Other assets and other liabilities		(51)		
Notes payable		21,348		
Other noncontrolling interests		(104)		
Conversion of Operating Partnership units held by noncontrolling interests for common stock	$		$	1,003
Acquisitions of real estate assets				
Real estate assets, net	$	6,475	$	
Notes payable		(6,475)		

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, develop and redevelop professionally managed self-storage facilities located throughout the United States. The Company continues the business of Extra Space Storage LLC and its subsidiaries, which had engaged in the self-storage business since 1977. The Company s interest in its properties is held through its operating partnership, Extra Space Storage LP (the Operating Partnership), which was formed on May 5, 2004. The Company s primary assets are general partner and limited partner interests in the Operating Partnership. This structure is commonly referred to as an umbrella partnership REIT, or UPREIT. The Company has elected to be taxed as a REIT under the Internal Revenue Code of 1986, as amended. 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 September 30, 2010, the Company had direct and indirect equity interests in 652 operating storage facilities. In addition, the Company managed 157 properties for franchisees and third parties, bringing the total number of operating properties which it owns and/or manages to 809 located in 34 states and Washington, D.C.

The Company operates in three distinct segments: (1) property management, acquisition and development; (2) rental operations; and (3) tenant reinsurance. The Company s property management, acquisition and development activities include managing, acquiring, developing and selling self-storage facilities. On June 2, 2009, the Company announced the wind-down of its development activities. As of September 30, 2010, there were six development projects in process that the Company expects to complete by the end of the second quarter of 2011. The rental operations activities include rental operations of self-storage facilities. No single tenant accounts for more than 5% of rental income. Tenant reinsurance activities include the reinsurance of risks relating to the loss of goods stored by tenants in the Company s self storage facilities.

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 nine months ended September 30, 2010 are not necessarily indicative of results that may be expected for the year ended December 31, 2010. The Condensed Consolidated Balance Sheet as of December 31, 2009 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, 2009 as filed with the Securities and Exchange Commission (SEC).

Recently Issued Accounting Standards

In June 2009, the Financial Accounting Standards Board (FASB) issued changes to Accounting Standards Codification (ASC) 810, *Consolidation,* which amended guidance for determining whether an entity is a variable interest entity (VIE), and requires the performance of a qualitative rather than a quantitative analysis to determine the primary beneficiary of a VIE. Under this guidance, an entity would be required to consolidate a VIE if it has (i) the power to direct the activities that most significantly impact the entity s economic performance and (ii) the obligation to absorb losses of the VIE or the right to receive benefits from the VIE that could be significant to the VIE. This guidance became effective for the first annual reporting period that began after November 15, 2009, with early adoption prohibited. The Company adopted this guidance effective January 1, 2010 and reviewed the terms for all joint ventures in relation to the new guidance. As a result of this analysis, the Company determined that five joint ventures that were consolidated under the previous accounting guidance should be deconsolidated as of January 1, 2010. The assets and liabilities associated with these joint ventures were removed from the Company s financial statements and the Company s investments in these joint ventures were recorded under the equity method of accounting during the three and nine months ended September 30, 2010.

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Reclassifications

Certain amounts in the 2009 financial statements and supporting note disclosures have been reclassified to conform to the current year presentation. Such reclassifications did not impact previously reported net income or accumulated deficit.

Fair Value Disclosures

Assets and Liabilities Measured at Fair Value on a Recurring Basis

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

		Fair Value Measurements at Reporting Date Using		
Description	**September 30, 2010**	**Quoted Prices in Active Markets for Identical Assets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**
Other liabilities - Swap Agreement 1	$ (2,351)	$	$ (2,351)	$
Other liabilities - Swap Agreement 2	(1,909)		(1,909)	
Other liabilities - Swap Agreement 3	(957)		(957)	
Other liabilities - Swap Agreement 4	(679)		(679)	
Other liabilities - Swap Agreement 5	(1,063)		(1,063)	
Other liabilities - Swap Agreement 6	(2,014)		(2,014)	
Total	$ (8,973)	$	$ (8,973)	$

The fair value of our derivatives is based on quoted market prices of similar instruments from various banking institutions or an independent third party provider for similar instruments. In determining the fair value, we consider our non-performance risk and that of our counterparties.

The Company did not have any significant assets or liabilities that are re-measured on a recurring basis using significant unobservable inputs (Level 3) for the three and nine months ended September 30, 2010.

Assets and Liabilities Measured at Fair Value on a Nonrecurring Basis

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

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

When real estate assets are identified by management as held for sale, the Company discontinues depreciating the assets and estimates the fair value of the assets, net of selling costs. If the estimated fair value, net of selling costs, of the assets that have been identified as held for sale is less than the net carrying value of the assets, then a valuation allowance is established. The operations of assets held for sale or sold during the period are generally presented as discontinued operations for all periods presented.

The Company assesses whether there are any indicators that the value of its investments in unconsolidated real estate ventures may be impaired annually and when events or circumstances indicate there may be 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.

The Company treats property acquisitions as businesses and records the related assets and liabilities at their fair values as of the acquisition date. Acquisition-related transaction costs are expensed as incurred. Intangible assets, which represent the value of existing tenant relationships, are recorded at their fair values based on the avoided cost to replace the current leases. The Company measures the value of tenant relationships based on the Company s historical experience with turnover in its facilities. Debt assumed as part of an acquisition is recorded at fair value based on current interest rates compared to contractual rates.

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

Fair Value of Financial Instruments

The carrying values of cash and cash equivalents, restricted cash, receivables, other financial instruments included in other assets, accounts payable and accrued expenses, variable rate notes payable and notes payable to trusts, lines of credit and other liabilities reflected in the condensed consolidated balance sheets at September 30, 2010 and December 31, 2009 approximate fair value. The fair values of the Company s notes receivable and fixed rate notes payable and notes payable to trusts are as follows:

	September 30, 2010		December 31, 2009	
	Fair Value	**Carrying Value**	**Fair Value**	**Carrying Value**
Note receivable from Preferred Operating Partnership unit holder	$ 117,782	$ 100,000	$ 112,740	$ 100,000
Fixed rate notes payable and notes payable to trusts	$ 733,423	$ 677,678	$ 1,067,653	$ 1,015,063
Exchangeable senior notes	$ 122,918	$ 87,663	$ 110,122	$ 87,663

3.   NET INCOME PER COMMON SHARE

Basic net income per common share is computed by dividing net income by the weighted average common shares outstanding including unvested share based payment awards that contain a non-forfeitable right to dividends or dividend equivalents. Diluted net income per common share measures the performance of the Company over the reporting period while giving effect to all potential common shares that were dilutive and outstanding during the period. The denominator includes the weighted average number of basic shares and the number of additional common shares that would have been outstanding if the potential common shares that were dilutive had been issued and is calculated using either the treasury stock or if-converted method. Potential common shares are securities (such as options, warrants, convertible debt, 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 non-discretionary changes in income or loss that would result from the assumed conversion of those potential common shares. In computing diluted earnings per share, only potential common shares that are dilutive, those which reduce earnings per share, are included.

The Company s Operating Partnership has $87,663 of exchangeable senior notes issued and outstanding as of September 30, 2010 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 $23.45 per share at September 30, 2010, and could change over time as described in the indenture. The price of the Company s common stock did not exceed 130% of the exchange price for the specified period of time during the third quarter of 2010; therefore holders of the exchangeable senior notes may not elect to convert them during the fourth quarter of 2010.

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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, ASC 260, *Earnings per Share,* requires an assumption that shares will be used to pay the exchange obligations in excess of the accreted principal amount, and requires that those shares be included in the Company s calculation of weighted average common shares outstanding for the diluted earnings per share computation. No shares were included in the computations for the three and nine months ended September 30, 2010 or 2009 because there was no excess over the accreted principal for these periods.

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 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 ASC 260-10-45-46.

For the three months ended September 30, 2010 and 2009, options to purchase 1,161,799 and 4,458,370 shares of common stock and for the nine months ended September 30, 2010 and 2009, options to purchase 2,187,449 and 5,237,237 shares of common stock, respectively, were excluded from the computation of earnings per share as their effect would have been anti-dilutive. All restricted stock grants have been included in basic and diluted shares outstanding because such shares earn a non-forfeitable dividend and carry voting rights.

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

	Three months ended September 30,		Nine months ended September 30,	
	2010	**2009**	**2010**	**2009**
Net income attributable to common stockholders	$ 7,667	$ 5,967	$ 17,415	$ 26,045
Add: Income allocated to noncontrolling interest - Preferred Operating Partnership and Operating Partnership	1,827	1,777	5,217	6,250
Subtract: Fixed component of income allocated to noncontrolling interest - Preferred Operating Partnership	(1,438)	(1,438)	(4,313)	(4,313)
Net income for diluted computations	$ 8,056	$ 6,306	$ 18,319	$ 27,982
Weighted average common shares outstanding:				
Average number of common shares outstanding - basic	87,484,731	86,437,877	87,244,161	86,260,442
Operating Partnership units	3,356,963	3,917,941	3,356,963	3,917,941
Preferred Operating Partnership units	989,980	989,980	989,980	989,980
Dilutive and cancelled stock options	358,178	203,186	378,765	153,140
Average number of common shares outstanding - diluted	92,189,852	91,548,984	91,969,869	91,321,503
Net income per common share				
Basic	$ 0.09	$ 0.07	$ 0.20	$ 0.30
Diluted	$ 0.09	$ 0.07	$ 0.20	$ 0.30

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4. REAL ESTATE ASSETS

The components of real estate assets are summarized as follows:

	September 30, 2010	December 31, 2009
Land - operating	$ 476,355	$ 501,674
Land - development	24,284	32,635
Buildings and improvements	1,585,480	1,675,340
Intangible assets - tenant relationships	31,214	33,463
Intangible lease rights	6,150	6,150
	2,123,483	2,249,262
Less: accumulated depreciation and amortization	(250,322)	(233,830)
Net operating real estate assets	1,873,161	2,015,432
Real estate under development	29,537	34,427
Net real estate assets	$ 1,902,698	$ 2,049,859
Real estate assets held for sale included in net real estate assets	$ 11,275	$ 11,275

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

On January 21, 2010, the Company entered into a joint venture with Harrison Street Real Estate Capital, LLC (Harrison Street). Harrison Street contributed $15,750 in cash to the joint venture in return for a 50% ownership interest. The Company contributed 19 wholly-owned properties with a fair market value of approximately $132,000 and received $15,750 in cash and a 50% ownership interest in the joint venture. There was no step up in basis for the 50% ownership retained by the Company. The joint venture assumed $101,000 of existing debt which is secured by the properties. The properties are located in California, Florida, Nevada, Ohio, Pennsylvania, Tennessee, Texas and Virginia. The Company deconsolidated the 19 properties as of the acquisition date and will continue to manage the properties in exchange for a management fee.

The transaction met all of the criteria for sale accounting and profit recognition under the partial sale criteria of ASC 360-40, *Real Estate Sales,* except for a provision in the agreement that was deemed to be a seller guarantee. Accordingly, the Company was required to assess the substance of the transaction to determine, first whether it was a sale, and second, whether there could be any partial profit recognition. Based on its review of the terms of the arrangement and a review of the property operating projections, the Company concluded that the transaction qualified as a sale and could potentially qualify for some profit recognition under the cost recovery or installment methods; however, because there are preferences on cash distributions, the Company can only recognize profit to the extent that the $15,750 invested by Harrison Street exceeded 100% of the Company s basis. Since the Company s basis was in excess of the $15,750, there was no profit recognition even though the transaction qualified for sale accounting. The Company recorded the deferred gain of $3,951 as a reduction of its investment in the joint venture with Harrison Street. The Company applied the guidance under ASC 810 and concluded that the joint venture with Harrison Street should be accounted for under the equity method of accounting.

5. PROPERTY ACQUISITIONS

The following table summarizes the Company s acquisitions of operating properties for the nine months ended September 30, 2010, and does not include purchases of raw land or improvements made to existing assets:

			Consideration Paid				Acquisition Date Fair Value				
Property Location	**Number of Properties**	**Date of Acquisition**	**Total Paid**	**Cash Paid**	**Loan Assumed**	**Net Liabilities (Assets) Assumed**	**Land**	**Building**	**Intangible**	**Closing costs - expensed**	**Source of Acquisition**
New York	1	5/21/2010	$ 9,629	$ 3,231	$ 6,475	$ (77)	$ 2,802	$ 6,536	$ 220	$ 71	Unrelated third party
Georgia	3	6/17/2010	7,661	7,551		110	2,769	4,487	318	87	Unrelated third party
Florida	1	7/15/2010	2,787	2,759		28	625	2,133	19	10	Unrelated third party
Alabama	2	8/23/2010	2,593	2,534		59	416	2,033	140	4	Unrelated third party

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The Company treats property acquisitions as businesses and records the related assets and liabilities at their fair values as of the acquisition date. Acquisition-related transaction costs are expensed as incurred.

6. INVESTMENTS IN REAL ESTATE VENTURES

Investments in real estate ventures consisted of the following:

	Equity Ownership %	Excess Profit Participation %	Investment balance at September 30, 2010	Investment balance at December 31, 2009
Extra Space West One LLC (ESW)	5%	40%	$1,198	$1,175
Extra Space West Two LLC (ESW II)	5%	40%	4,645	4,749
Extra Space Northern Properties Six LLC (ESNPS)	10%	35%	1,184	1,388
Extra Space of Santa Monica LLC (ESSM)	48%	48%	2,919	2,419
Clarendon Storage Associates Limited Partnership (Clarendon)	50%	50%	3,210	3,245
HSRE-ESP IA, LLC (HSRE)	50%	50%	12,691	
PRISA Self Storage LLC (PRISA)	2%	17%	11,510	11,907
PRISA II Self Storage LLC (PRISA II)	2%	17%	9,912	10,239
PRISA III Self Storage LLC (PRISA III)	5%	20%	3,643	3,793
VRS Self Storage LLC (VRS)	45%	54%	44,824	45,579
WCOT Self Storage LLC (WCOT)	5%	20%	4,849	4,983
Storage Portfolio I LLC (SP I)	25%	25-40%	15,095	16,049
Storage Portfolio Bravo II (SPB II)	20%	20-45%	14,828	15,104
Extra Space Joint Ventures with Everest Real Estate Fund (Everest)	10-58%	35-50%	5,517	1,558
U-Storage de Mexico S.A. and related entities (U-Storage)	40%	40%	6,140	6,166
Other minority owned properties	10-70%	10-50%	1,956	2,095
			$144,121	$130,449

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.

In accordance with ASC 810, the Company reviews all of its joint venture relationships quarterly to ensure that there are no entities that require consolidation. As of September 30, 2010, there were no previously unconsolidated entities that were required to be consolidated as a result of this review.

On June 15, 2010, the Company paid $193 to obtain an additional 7.2% percentage interest in ESSM, increasing the Company s interest in the venture from 41.0% to 48.2%.

On June 28, 2010, the Company contributed $6,660 to ESW as a result of a capital call related to the joint venture s repayment of its $16,650 loan. On August 25, 2010, ESW closed on a new loan and on August 30, 2010, ESW returned $6,660 of investment capital to the Company.

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

	Three months ended September 30, 2010	Three months ended September 30, 2009	Nine months ended September 30, 2010	Nine months ended September 30, 2009
Equity in earnings of ESW	$ 335	$ 294	$ 938	$ 878
Equity in losses of ESW II	(5)	(9)	(20)	(19)
Equity in earnings of ESNPS	69	119	177	215
Equity in losses of ESSM	(26)	(68)	(124)	(68)
Equity in earnings of Clarendon	118	101	309	285
Equity in losses of HSRE	(44)		(82)	
Equity in earnings of PRISA	168	177	479	324
Equity in earnings of PRISA II	77	138	344	415
Equity in earnings of PRISA III	71	63	193	179
Equity in earnings of VRS	583	517	1,632	1,569
Equity in earnings of WCOT	65	56	184	184
Equity in earnings of SP I	268	183	675	648
Equity in earnings of SPB II	53	27	135	260
Equity in earnings (losses) of Everest	52	2	138	(23)
Equity in earnings (losses) of U-Storage	(31)	(8)	(26)	1
Equity in earnings (losses) of other minority owned properties	(17)	160	(156)	440
	$ 1,736	$ 1,752	$ 4,796	$ 5,288

Equity in earnings (losses) of ESW II, HSRE, SP I and SPB II and a minority owned property in Annapolis, Maryland includes the amortization of the Company s excess purchase price of $26,075 of these equity investments over its original basis. The excess basis is amortized over 40 years.

Variable Interests in Unconsolidated Real Estate Joint Ventures:

The Company has interests in four unconsolidated joint ventures with unrelated third parties which are VIEs (the VIE JVs). The Company holds 18-70% equity interests in the VIE JVs, and has 50% of the voting rights in each of the VIE JVs. Qualification as a VIE was based on the determination that the equity investments at risk for each of these joint ventures was not sufficient based on a qualitative and quantitative analysis performed by the Company. The Company performed a qualitative analysis for these joint ventures to determine which party was the primary beneficiary of each VIE. The Company determined that since the powers to direct the activities most significant to the economic performance of these entities are shared equally by the Company and its joint venture partners, there is no primary beneficiary. Accordingly, these interests are recorded using the equity method.

The VIE JVs each own a single pre-stabilized self-storage property. These joint ventures are financed through a combination of (1) equity contributions from the Company and its joint venture partners, (2) mortgage notes payable and (3) payables to the Company. The payables to the Company consist of amounts owed for expenses paid on behalf of the joint ventures by the Company as manager and mortgage notes payable to the Company. The Company performs management services for the VIE JVs in exchange for a management fee of approximately 6% of cash collected by the properties. The Company has not provided financial or other support during the periods presented to the VIE JVs that it was not previously contractually obligated to provide.

The Company guarantees the mortgage notes payable for the VIE JVs. The Company s maximum exposure to loss for these joint ventures as of September 30, 2010 is the total of the guaranteed loan balances, the payables due to the Company and the Company s investment balances in the joint ventures. The Company believes that the risk of incurring a loss as a result of having to perform on the loan guarantees is unlikely and therefore no liability has been recorded related to these guarantees. Also, repossessing and/or selling the self-storage facility and land that collateralize the loans could provide funds sufficient to reimburse the Company. Additionally, the Company believes the payables to the Company are collectible.

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The following table compares the liability balance and the maximum exposure to loss related to the VIE JVs as of September 30, 2010:

	Liability Balance	Investment Balance	Balance of Guaranteed Loan	Payables to Company	Maximum Exposure to Loss	Difference
Extra Space of Elk Grove	$	527	4,811	2,820	$ 8,158	$ (8,158)
ESS of Sacramento One LLC		(765)	5,000	5,348	9,583	(9,583)
ES of Washington Avenue LLC		405	6,129	2,896	9,430	(9,430)
ES of Franklin Blvd LLC		(304)	2,947	4,569	7,212	(7,212)
	$	$ (137)	$ 18,887	$ 15,633	$ 34,383	$ (34,383)

The Company had no consolidated VIEs during the three and nine months ended September 30, 2010.

7. OTHER ASSETS

The components of other assets are summarized as follows:

	September 30, 2010	December 31, 2009
Equipment and fixtures	$ 13,057	$ 11,836
Less: accumulated depreciation	(10,065)	(9,046)
Other intangible assets	3,343	3,303
Deferred financing costs, net	14,065	15,458
Prepaid expenses and deposits	7,856	5,173
Accounts receivable, net	12,007	15,086
Investments in Trusts	3,590	3,590
Deferred tax asset	5,194	5,576
	$ 49,047	$ 50,976

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8. NOTES PAYABLE

The components of notes payable are summarized as follows:

	September 30, 2010	December 31, 2009
Fixed Rate		
Mortgage and construction loans with banks (includling loans subject to interest rate swaps) bearing interest at fixed rates between 4.2% and 7.3%. 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 June 2011 and August 2019.	$ 641,595	$ 895,473
Variable Rate		
Mortgage and construction loans with banks bearing floating interest rates based on LIBOR and Prime. Interest rates based on LIBOR are between LIBOR plus 1.5% (1.8% and 1.7% at September 30, 2010 and December 31, 2009, respectively) and LIBOR plus 4.0% (4.3% and 4.2% at September 30, 2010 and December 31, 2009, respectively). Interest rates based on Prime are between Prime plus 0.5% (3.8% at September 30, 2010 and December 31, 2009), and Prime plus 1.5% (4.8% at September 30, 2010 and December 31, 2009). 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 2010 and May 2015.	210,217	204,120
	$ 851,812	$ 1,099,593

Certain mortgage and construction loans with variable rate debt are subject to interest rate floors starting at 4.5%. Real estate assets are pledged as collateral for the notes payable. Also, certain of these notes payable are cross-collateralized with other properties. Of the Company s $851,812 in notes payable outstanding as of September 30, 2010, $421,272 were recourse due to guarantees or other security provisions. The Company is subject to certain restrictive covenants relating to the outstanding notes payable. The Company was in compliance with all financial covenants at September 30, 2010.

9. DERIVATIVES

GAAP requires the recognition of all derivative instruments as either assets or liabilities on the balance sheet at fair value. The accounting for changes in fair value of a derivative instrument depends on whether it has been designated and qualifies as part of a hedging relationship and further, on the type of hedging relationship. A company must designate each qualifying hedging instrument, based upon the exposure being hedged, as a fair value hedge, cash flow hedge, or a hedge of a net investment in foreign operations.

The Company is exposed to certain risks relating to its ongoing business operations. The primary risk managed by using derivative instruments is interest rate risk. Interest rate swaps are entered into to manage interest rate risk associated with Company s fixed and variable-rate borrowings. The Company designates certain interest rate swaps as cash flow hedges of variable-rate borrowings and the remainder as fair value hedges of fixed-rate borrowings.

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The following table summarizes the terms of the Company s derivative financial instruments at September 30, 2010:

Hedge Product	Hedge Type		Notional Amount	Strike	Effective Date	Maturity
Reverse Swap Agreement	Fair Value	$	61,770	Libor plus 0.65%	10/31/2004	6/1/2009
Swap Agreement 1	Cash Flow	$	63,000	4.24%	2/1/2009	6/30/2013
Swap Agreement 2	Cash Flow	$	26,000	6.32%	7/1/2009	7/1/2014
Swap Agreement 3	Cash Flow	$	8,462	6.98%	7/27/2009	6/27/2016
Swap Agreement 4	Cash Flow	$	10,000	6.12%	11/2/2009	11/1/2014
Swap Agreement 5	Cash Flow	$	20,700	5.80%	6/11/2010	6/1/2015
Swap Agreement 6	Cash Flow	$	48,876	6.10%	7/1/2010	9/1/2014

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

Type	Classification of Income (Expense)	Three months ended September 30,				Nine months ended September 30,			
			2010		2009		2010		2009
Reverse Swap Agreement	Interest expense	$		$		$		$	916
Swap Agreement 1	Interest expense		(554)		(307)		(1,183)		(609)
Swap Agreement 2	Interest expense		(179)		(124)		(547)		(124)
Swap Agreement 3	Interest expense		(74)		(49)		(218)		(49)
Swap Agreement 4	Interest expense		(64)				(196)		
Swap Agreement 5	Interest expense		(101)				(101)		
Swap Agreement 6	Interest expense		(224)				(224)		
		$	(1,196)	$	(480)	$	(2,469)	$	134

Information relating to the gains recognized on the swap agreements is as follows:

Type		Gain (loss) recognized in OCI September 30, 2010	Location of amounts reclassified from OCI into income		Gain (loss) reclassified from OCI Nine months ended September 30, 2010
Swap Agreement 1	$	(2,351)	Interest expense	$	(1,183)
Swap Agreement 2		(1,909)	Interest expense		(547)
Swap Agreement 3		(957)	Interest expense		(218)
Swap Agreement 4		(679)	Interest expense		(196)
Swap Agreement 5		(1,063)	Interest expense		(101)
Swap Agreement 6		(2,014)	Interest expense		(224)
	$	(8,973)		$	(2,469)

The Swap Agreements were highly effective for the nine months ended September 30, 2010. The losses reclassified from other comprehensive income (OCI) in the preceding table represent the effective portion of the Company s cash flow hedges reclassified from OCI to interest expense during the nine months ended September 30, 2010.

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The balance sheet classification and carrying amounts of the interest rate swaps are as follows:

	Asset (Liability) Derivatives			
	September 30, 2010		December 31, 2009	
Derivatives designated as hedging instruments:	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value
Swap Agreement 1	Other liabilities	$ (2,351)	Other liabilities	$ (340)
Swap Agreement 2	Other liabilities	(1,909)	Other liabilities	(478)
Swap Agreement 3	Other liabilities	(957)	Other liabilities	(244)
Swap Agreement 4	Other liabilities	(679)	Other liabilities	(49)
Swap Agreement 5	Other liabilities	(1,063)	N/A	
Swap Agreement 6	Other liabilities	(2,014)	N/A	
		$ (8,973)		$ (1,111)

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 had a fixed rate of 6.91% through July 31, 2010, and is now 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 became redeemable by the Trust with no prepayment premium on 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 had a fixed rate of 6.67% through June 30, 2010, and is now 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 became redeemable by the Trust with no prepayment premium on June 30, 2010.

During April 2005, ESS Statutory Trust I (the Trust), a newly formed Delaware statutory trust and a wholly-owned, unconsolidated subsidiary of the Operating Partnership issued an aggregate of $35,000 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. Effective June 30, 2010, the Trust entered into an interest rate swap that fixes the interest rate to be paid at 5.62% and matures on June 30, 2015. 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 became redeemable by the Trust with no prepayment premium on June 30, 2010.

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

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

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Following is a tabular comparison of the liabilities the Company has recorded as a result of its involvement with the trusts and the maximum exposure to loss the Company is subject to related to the trusts as of September 30, 2010:

	Notes payable to Trusts as of September 30, 2010	Maximum exposure to loss	Difference
Trust	$ 36,083	$ 35,000	$ 1,083
Trust II	42,269	41,000	1,269
Trust III	41,238	40,000	1,238
	$ 119,590	$ 116,000	$ 3,590

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

11. EXCHANGEABLE SENIOR NOTES

On March 27, 2007, the Company s Operating Partnership issued $250,000 of its 3.625% Exchangeable Senior Notes due April 1, 2027 (the Notes). Costs incurred to issue the Notes were approximately $5,700. The remaining portion of 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 September 30, 2010. 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 common stock or a combination of cash and shares of common stock at an exchange rate of approximately 42.6491 shares per one thousand dollars principal amount of Notes at the option of the Operating Partnership.

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

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

GAAP requires entities with convertible debt instruments that may be settled entirely or partially in cash upon conversion to separately account for the liability and equity components of the instrument in a manner that reflects the issuer s economic interest cost. The Company therefore accounts for the liability and equity components of the Notes separately. The equity component is included in the paid-in-capital section of stockholders equity on the condensed consolidated balance sheet, and the value of the equity component is treated as original issue discount for purposes of accounting for the debt component. The discount is being amortized over the period of the debt as additional interest expense.

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

	September 30, 2010	December 31, 2009
Carrying amount of equity component	$ 19,545	$ 19,545
Principal amount of liability component	$ 87,663	$ 87,663
Unamortized discount	(2,633)	(3,869)
Net carrying amount of liability component	$ 85,030	$ 83,794

The discount will be amortized over the remaining period of the debt through its first redemption date of April 1, 2012. The effective interest rate on the liability component is 5.75%.

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The amount of interest cost recognized relating to the contractual interest rate and the amortization of the discount on the liability component is as follows:

	Three months ended September 30,		Nine months ended September 30,	
	2010	2009	2010	2009
Contractual interest	$ 801	$ 870	$ 2,377	$ 3,723
Amortization of discount	416	430	1,236	1,834
Total interest expense recognized	$ 1,217	$ 1,300	$ 3,613	$ 5,557

Repurchases of Notes

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

Information on the repurchases made during the nine months ended September 30, 2009 and the related gains is as follows:

	May 2009	March 2009
Principal amount repurchased	$ 43,000	$ 71,500
Amount allocated to:		
Extinguishment of liability component	$ 35,000	$ 43,800
Reacquisition of equity component	1,340	713
Total cash paid for repurchase	$ 36,340	$ 44,513
Exchangeable senior notes repurchased	$ 43,000	$ 71,500
Extinguishment of liability component	(35,000)	(43,800)
Discount on exchangeable senior notes	(2,349)	(4,208)
Related debt issuance costs	(558)	(1,009)
Gain on repurchase	$ 5,093	$ 22,483

There were no repurchases made during the nine months ended September 30, 2010.

12. LINES OF CREDIT

On June 4, 2010, a subsidiary of the Company entered into a $45,000 revolving secured line of credit (the Third Credit Line) that is collateralized by mortgages on certain lease-up real estate assets and matures on May 31, 2013 with a two-year extension option available. The Company intends to use the proceeds of the Third Credit Line to repay debt and for general corporate purposes. The Third Credit Line has an interest rate of LIBOR plus 350 basis points (3.8% at September 30, 2010). The Third Credit Line is guaranteed by the Company. As of September 30, 2010, the Third Credit Line had $25,467 of capacity based on the lease-up of the assets collateralizing the Third Credit Line. At September 30, 2010, $10,000 was drawn on the Third Credit Line.

On February 13, 2009, a subsidiary of the Company entered into a $50,000 revolving secured line of credit (the Secondary Credit Line) that is collateralized by mortgages on certain real estate assets and matures on February 13, 2013 with an option to extend one additional year. The Company intends to use the proceeds of the Secondary Credit Line to repay debt and for general corporate purposes. The Secondary Credit Line has an interest rate of LIBOR plus 350 basis points (3.8% at September 30, 2010 and 3.7% at December 31, 2009). As of September 30, 2010 and December 31, 2009, there was $5,000 and $0, respectively, drawn on the Secondary Credit Line. The Secondary Credit Line is guaranteed by the Company.

On October 16, 2007, a subsidiary entered into a $100,000 revolving secured line of credit (the Credit Line and together with the Secondary Credit Line and the Third Credit Line, the Credit Lines) that matures on October 31, 2010 with two one-year extensions available. As of September 30, 2010 and December 31, 2009, $100,000 was drawn on the Credit Line. The Company intends to use

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the proceeds of the Credit Line to repay debt and for general corporate purposes. The Credit Line has an interest rate of between 100 and 205 basis points over LIBOR, depending on certain financial ratios of the Company (1.3% at September 30, 2010 and 1.2% at December 31, 2009). The Credit Line is collateralized by mortgages on certain real estate assets. As of September 30, 2010, the Credit Line had $100,000 of capacity based on the assets collateralizing the Credit Line.

13. OTHER LIABILITIES

The components of other liabilities are summarized as follows:

	September 30, 2010	December 31, 2009
Deferred rental income	$ 11,655	$ 12,045
Lease obligation liability	7,287	6,260
Fair value of interest rate swaps	8,973	1,111
Income taxes payable (receivable)	(4)	2,145
Other miscellaneous liabilities	4,330	3,413
	$ 32,241	$ 24,974

The lease obligation liability increased by $2,000 in the period ended September 30, 2010 as a result of the bankruptcy of a tenant subleasing office space from the Company in Memphis, TN. The Memphis, TN office lease is a liability assumed in the Storage USA acquisition in July, 2005. The increase in this liability was recognized through a $2,000 charge, which is included in loss on sublease in the condensed consolidated statement of operations.

14. RELATED PARTY AND AFFILIATED REAL ESTATE JOINT VENTURE TRANSACTIONS

The Company provides management services to certain joint ventures, franchises, third parties and other related party properties. Management agreements provide generally for management fees of 6% of gross rental revenues 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:

		Three months ended September 30,		Nine months ended September 30,	
Entity	Type	2010	2009	2010	2009
ESW	Affiliated real estate joint ventures	$ 102	$ 100	$ 303	$ 302
ESW II	Affiliated real estate joint ventures	80	79	238	233
ESNPS	Affiliated real estate joint ventures	116	111	342	339
ESSM	Affiliated real estate joint ventures	12	5	29	5
HSRE	Affiliated real estate joint ventures	259		704	

PRISA	Affiliated real estate joint ventures	1,223	1,188	3,592	3,619
PRISA II	Affiliated real estate joint ventures	997	993	2,969	2,995
PRISA III	Affiliated real estate joint ventures	437	422	1,283	1,263
VRS	Affiliated real estate joint ventures	289	281	850	848
WCOT	Affiliated real estate joint ventures	371	361	1,096	1,093
SP I	Affiliated real estate joint ventures	319	310	940	937
SPB II	Affiliated real estate joint ventures	239	236	704	712
Everest	Affiliated real estate joint ventures	137	114	393	341
Other	Franchisees, third parties and other	1,270	991	3,613	2,998
		$ 5,851	$ 5,191	$ 17,056	$ 15,685

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Receivables from related parties and affiliated real estate joint ventures are summarized as follows:

	September 30, 2010	December 31, 2009
Mortgage notes receivable	$ 13,442	$
Other receivables from properties	11,151	5,114
	$ 24,593	$ 5,114

Other receivables from properties consist of amounts due for management fees, development fees and expenses paid by the Company on behalf of the properties that the Company manages. The Company believes that all of these related party and affiliated joint venture receivables are fully collectible. The Company did not have any payables to related parties at September 30, 2010 or December 31, 2009.

In January 2009, the Company purchased a lender s interest in a construction loan from a joint venture that owns a single property located in Sacramento, CA. The construction loan was to ESS of Sacramento One, LLC, a joint venture in which the Company owns a 50% interest, and was guaranteed by the Company. In July 2009, the Company purchased a lender s interest in a mortgage note from a joint venture that owns a single property located in Chicago, IL. The note was to Extra Space of Montrose, a joint venture in which the Company holds a 39% interest, and was also guaranteed by the Company. Both ESS of Sacramento One, LLC and Extra Space of Montrose were consolidated as of December 31, 2009, as each joint venture was considered to be a VIE of which the Company was the primary beneficiary. The construction loan and mortgage note receivable were eliminated by the Company in consolidation as of December 31, 2009. On January 1, 2010, the Company adopted changes to the accounting guidance in ASC 810, *Consolidation.* As a result of the adoption of this new guidance, the Company determined that these joint ventures should no longer be consolidated as the power to direct the activities that most significantly impact these entities economic performance is shared equally by the Company and their joint venture partners, and therefore there is no primary beneficiary of either joint venture. The Company therefore deconsolidated these joint ventures as of January 1, 2010, and removed the associated assets and liabilities from its books. The $7,295 note receivable from Extra Space of Montrose and the $3,824 loan receivable from ESS of Sacramento One, LLC are no longer eliminated in consolidation as the Company now accounts for its interest in these joint ventures using the equity method of accounting.

In August 2010, Extra Space of Franklin Boulevard LLC, a joint venture in which the Company holds a 50% interest, closed an amendment and extension of their existing loan. This amendment required a partial pay down of the existing loan. The Company loaned $2,323 to the joint venture, which is classified by the Company as a mortgage note receivable.

Centershift, a related party service provider, is partially owned by certain directors and members of management of the Company. Effective January 1, 2004, the Company entered into a license agreement with Centershift 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 $211 and $352 for the three months ended September 30, 2010 and 2009, respectively, and $583 and $820 for the nine months ended September 30, 2010 and 2009, respectively, relating to the purchase of software and to license agreements.

The Company has entered into an aircraft dry lease and service and management agreement with SpenAero, L.C. (SpenAero), an affiliate of Spencer F. Kirk, the Company s Chairman and Chief Executive Officer. Under the terms of the agreement, the Company pays a defined hourly rate for use of the aircraft. The Company paid SpenAero and related entities $170 and $151 for the three months ended September 30, 2010 and 2009, respectively, and $520 and $623 for the nine months ended September 30, 2010 and 2009, respectively. The services that the Company receives from SpenAero are similar in nature and price to those that are provided to other outside third parties.

15. 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 and 50,000,000 shares of preferred stock, $0.01 par value per share. As of September 30, 2010, 87,545,312 shares of common stock 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 per share held on all matters submitted to a vote of stockholders. The transfer agent and registrar for the Company s common stock is American Stock Transfer & Trust Company.

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16. NONCONTROLLING 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 AAAAA 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. There were 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 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 participates in distributions with and has a liquidation value equal to that of the common OP units. The Preferred OP units became redeemable at the option of the holder on September 1, 2008, which redemption obligation may be satisfied, at the Company s option, in cash or shares of its common stock.

On September 18, 2008, the Operating Partnership entered into a First Amendment to the Second Amended and Restated Agreement of Limited Partnership of Extra Space Storage LP to clarify certain tax-related provisions relating to the Preferred OP units.

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

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

17. NONCONTROLLING INTEREST IN OPERATING PARTNERSHIP

The Company s interest in its properties is held through the Operating Partnership. ESS Holding Business Trust I, a wholly owned subsidiary of the Company, is the sole general partner of the Operating Partnership. 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 95.3% majority ownership interest therein as of September 30, 2010. The remaining ownership interests in the Operating Partnership (including Preferred OP units) of 4.7% are held by certain former owners of assets acquired by the Operating Partnership. As of September 30, 2010, the Operating Partnership had 3,356,963 common OP units outstanding.

The noncontrolling interests in the Operating Partnership represent common OP units that are not owned by the Company. In conjunction with the formation of the Company and as a result of subsequent acquisitions, certain persons and entities contributing interests in properties to the Operating Partnership received limited partnership units in the form of either OP units or Contingent Conversion Units. Limited partners who received OP units in the formation transactions or in exchange for contributions for interests

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in properties have the right to require the Operating Partnership to redeem part or all of their common OP units for cash based upon the fair market value of an equivalent number of shares of the Company s common stock (ten 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 September 30, 2010, was $16.43 and there were 3,356,963 common OP units outstanding. Assuming that all of the unit holders exercised their right to redeem all of their common OP units on September 30, 2010, and the Company elected to pay the noncontrolling members cash, the Company would have paid $55,155 in cash consideration to redeem the OP units.

During July 2010, 90,135 OP units were redeemed for $1,314 in cash. During August 2010, 180,270 OP units were redeemed for $2,802 in cash.

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

The Company has evaluated the terms of the common OP units and classifies the noncontrolling interest in the Operating Partnership as stockholders equity in the accompanying condensed consolidated balance sheets. The Company will periodically evaluate individual noncontrolling interests for the ability to continue to recognize the noncontrolling amount as permanent equity in the condensed consolidated balance sheets. Any noncontrolling interests that fail to quality as permanent equity will be reclassified as temporary equity and adjusted to the greater of (a) the carrying amount, or (b) its redemption value as of the end of the period in which the determination is made.

18. OTHER NONCONTROLLING INTERESTS

Other noncontrolling interests represent the ownership interests of various third parties in three consolidated self-storage properties as of September 30, 2010. Two of these consolidated properties were under development, and one was in the lease-up stage at September 30, 2010. The ownership interests of the third party owners range from 10% to 35%. Other noncontrolling interests are included in the stockholders equity section of the Company s condensed consolidated balance sheet. The income or losses attributable to these third party owners based on their ownership percentages are reflected in net income allocated to the Operating Partnership and other noncontrolling interests in the condensed consolidated statement of operations.

On June 25, 2010, the Company acquired all of its minority partners membership interests in two consolidated self-storage properties located in New Jersey for a total of $50 in cash. Both of these properties are in the lease-up stage and are now wholly owned by the Company.

19. STOCK-BASED COMPENSATION

The Company has the following plans under which shares were available for grant at September 30, 2010:

- The 2004 Long-Term Incentive Compensation Plan as amended and restated effective March 25, 2008, and
- The 2004 Non-Employee Directors Share Plan (together, the Plans).

Option grants are issued with an exercise price equal to the closing price of the Company s common stock on the date of grant. Unless otherwise determined by the Compensation, Nominating and Governance Committee at the time of grant, options vest ratably over a four-year period beginning on the date of grant. Each option will be exercisable once it has vested. Options are exercisable at such times and subject to such terms as determined by the Compensation, Nominating and Governance Committee, but under no circumstances will be exercised if such exercise would cause a violation of the ownership limit in the Company s charter. Options expire 10 years from 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 non-forfeitable dividends paid on the shares. The forfeiture and transfer restrictions on the shares lapse over a four-year period beginning on the date of grant.

As of September 30, 2010, 3,029,012 shares were available for issuance under the Plans.

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A summary of stock option activity is as follows:

Options	Number of Shares		Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (Years)		Aggregate Intrinsic Value as of September 30, 2010
Outstanding at December 31, 2009	3,457,048	$	13.02			
Granted	308,680		11.75			
Exercised	(442,990)		11.51			
Forfeited	(157,562)		12.27			
Outstanding at September 30, 2010	3,165,176	$	13.14	6.10	$	10,263
Vested and Expected to Vest	3,001,050	$	13.33	5.96	$	9,208
Ending Exercisable	2,131,346	$	14.47	5.01	$	4,147

The aggregate intrinsic value in the table above represents the total value (the difference between the Company s closing stock price on the last trading day of the third quarter of 2010 and the exercise price, multiplied by the number of in-the-money options) that would have been received by the option holders had all option holders exercised their options on September 30, 2010. The amount of aggregate intrinsic value will change based on the fair market value of the Company s stock.

The weighted average fair value of stock options granted for the nine months ended September 30, 2010 and 2009, was $3.27 and $1.31, respectively. The fair value of each option grant is estimated using the Black-Scholes option-pricing model with the following weighted average assumptions:

	Nine months ended September 30, 2010	2009
Expected volatility	47%	48%
Dividend yield	5.3%	3.5%
Risk-free interest rate	2.3%	2.3%
Average expected term (years)	5	5