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DCT Industrial Trust, Inc. *(DCT)*

Q2 2012 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good day, and welcome to the DCT Industrial Trust Second Quarter 2012 Earnings Conference Call and Webcast. All participants will be in listen-only mode. [Operator Instructions] . After today's presentation, there will be an opportunity to ask questions. [Operator Instructions] Please note this event is being recorded.

I'd like to turn the conference over to Ms. Melissa Sachs, Vice President-Corporate Communications. Ms. Sachs, the floor is yours, Ma'am.

Melissa Sachs
VP-Corporate Communications & Investor Relations, DCT Industrial Trust, Inc.

Thank you. Hello, everyone and thank you for joining DCT Industrial Trust second quarter 2012 earnings call. Today call will be led by Phil Hawkins, our President and Chief Executive Officer; and Matt Murphy, our CFO, who'll provide more details on the quarter's results as well as our guidance. Additionally, Jeff Phelan, our National President of Development, and Managing Director of our West Region will be available to answer questions about the markets and our real estate activities.

Before I turn the call over to Phil, I would like to remind everyone that management's remarks on today's call will include forward-looking statements within the meaning of Federal Securities Laws. This includes without limitation, statements regarding projections, plans or future expectations. Actual results may differ materially from those described in the forward-looking statements and will be affected by a variety of risks, including those

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set forth in our earnings release and in our Form 10-K filed with the SEC, as updated by our quarterly reports on Form 10-Q.

Additionally, on this conference call, we may refer to certain non-GAAP financial measures. Reconciliations of these non-GAAP financial measures are available in our supplemental, which can be found in the Investor Relations section of our website at dctindustrial.com.

And now, I will turn the call over to Phil.

Philip L. Hawkins

President & Chief Executive Officer, DCT Industrial Trust, Inc.

Thanks, Melissa, and welcome, everyone. We had another strong quarter specifically with regards to both leasing and capital recycling. Our market teams are doing a great job competing on a local level, leasing space, acquiring quality assets, often in non-marketed transactions, and sourcing and executing on our value-add and development projects.

I continue to be very pleased with our operating results, especially leasing, which in the first half of the year has significantly exceeded our initial expectations. Highlights of the second quarter include leasing 5.8 million square feet in the quarter, a 45% increase over the second quarter of last year, and a 75% increase over last quarter. This included 1.9 million square feet of new leases, 300,000 square feet of expansions, and 3.6 million square feet of renewals.

Quarter end, the consolidated occupancy increased to 90.2% from last quarter's 90.1% with an additional 2% leased, but not yet occupied. Same-store NOI increased 6.3% on a cash basis, and 3.5% on a GAAP basis driven by both higher occupancy and higher net effective rents.

Rents declined 6.1% on a cash basis, and increased 1% on a GAAP basis. As a result of the strong quarter, we moved the bottom end of our guidance up from $0.38 to $0.39, moving the midpoint up to $0.405. I know that every investor and analyst is interested in the current leasing in market. The summer months of July and August are typically the slowest of the year and not surprisingly new deal activity slowed somewhat in July. Some of this slowing may also be attributable to anxiety over the economy and related political discourse. While down compared to the torrid pace coming into the summer, there is activity and tenants continue to make decisions, although in some cases at a slower pace.

My own expectation is that market activity will pick up again after the summer, although most likely at a less brisk pace than the record levels of the second quarter. And then hopefully, the election will bring some query one way or the other, reducing some of the uncertainty and bumpiness in the economic and real estate markets.

Yesterday's sales reports – retail sales reports and this morning's jobs report offer some modest encouragement. Also encouraging to me is a somewhat positive data coming out of the housing industry. It appears that this very important driver of distribution space demand, which has been on at the back for four years, now has at least a slight pulse and may finally be responding to the obvious benefits of incredibly cheap mortgage rates. While very early, we have seen a few housing- related lease requirements coming to our system and we are rooting for this important sector to continue and even accelerate its recovery.

Moving on to capital deployment, we continue to make good steady progress, finding mostly one-off acquisitions in our focus markets at decent returns. While we know there maybe some skepticism about the term off-market, our teams truly have been successful proactively calling on owners of assets to identify opportunities within our

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targeted submarkets. While this is hard work, we find it more productive and profitable than competing in brokered auctions.

As a result of our market teams' efforts, we acquired nine buildings totaling $86 million since the end of the first quarter, roughly a third of those acquisitions were less than 90% occupied, reflecting our continued willingness to take our leasing and redevelopment risk in markets where we are confident of leasing and where we believe we can generate an attractive risk-adjusted return. This is consistent with our strategy over the past two years and, I will add, we are significantly ahead of our initial leasing projections for our various value-add acquisitions.

Our pipeline of potential acquisitions remains pretty active. We have some smaller transactions under agreement and are working on several more significant transactions that I am hopeful will gain traction. We continue to make excellent progress with our development business as well. In the second quarter, we started DCT55, a 600,000 square foot cross-dock building located in the I-55 Corridor of Chicago.

In July, we commenced construction on a 177,000 square foot expansion of Building 3 at SCLA. This building is, and will continue to be, fully occupied by Newell Rubbermaid under a long-term lease and demonstrate its commitment to that location.

We expect to start two other buildings by year-end, Slover Commerce Center, a 650,000 square-foot cross-dock building in the Inland Empire West and Building 2 at DCT Commerce Center in the Airport West submarket of Miami.

With regard to leasing of our development pipeline, we've pre-leased all of our two-building Dulles Summit Phase II projects, and we've strong activity at our other development projects, including two larger transactions that are in the advanced lease negotiation stage.

Economics and lease timing are progressing well ahead of our initial projections for the development program. Our development efforts continue to be focused on one or two building projects in infill locations where we can minimize land carry. I have no interest in building up a large land bank on our balance sheet, but instead I'm focused on sites that we can quickly put into production in markets and locations where we believe the economics make sense today.

With respect to dispositions, we sold 16 building for $32 million since the end of the first quarter. These were older flex and light industrial buildings that are not consistent with our long-term market, and/or building criteria. We're pleased with the pricing, and happy to recycle capital into newer higher quality assets that we believe will generate higher returns and growth over time.

We are also under contract to sell 13 buildings in Houston, totaling about 1 million square feet and have several other packages on the market, as well as working on a few potential user sales.

In short, I feel very good about our disposition efforts both completed and underway. Our focus in the coming months will remain on leasing space, both in our operating and development portfolios, and recycling capital out of lower growth assets into higher growth, higher quality acquisitions and developments.

We're off to a great start in the first half of the year, and I'm very optimistic about our ability to continue making strong progress over the balance of the year.

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While mindful that global and U.S economic and political uncertainty will have some impact over the balance of the year, we didn't expect a bump-free recovery, and we remain quite confident in our ability to achieve our 2012 plan.

Beyond 2012, I'm quite optimistic that the economy will continue its modest although uneven recovery and that industrial real estate fundamentals will continue to strengthen.

Let me now turn the call over to Matt Murphy for additional color on the quarter and our outlook for the remainder of the year. Matt?

Matthew T. Murphy

Chief Financial Officer, Treasurer & Executive VP, DCT Industrial Trust, Inc.

Thanks, Phil, and good morning, everyone. The second quarter of 2012 at DCT continued the theme of recent quarters with steady improvement in fundamentals and continued success on our strategic initiatives. Consolidated occupancy increased approximately 10 basis points during the quarter, and we ended solidly ahead of plan at 90.2%. This increase happened despite previously known move-outs of 500,000 square feet in Memphis and 400,000 square feet in Atlanta. Most of the space in Atlanta has already been back filled well ahead of plan and we have some activity in Memphis as well.

We have limited lease expirations for the remainder of the year, just over 3 million square feet, and we have 1.2 million square feet or 2% of our portfolio currently leased but not yet occupied. As a result, we feel very good about our projections of exceeding 93% occupied in our operating portfolio by year-end.

Our same-store operating results continued their positive trend in the second quarter, increasing 3.5% on a GAAP basis and 6.3% on a cash basis. This improvement was predominantly driven by revenues as average occupancy in the same-store pool was 230 basis points higher in the second quarter of 2012 versus the same period of 2011.

It's also important to note that cash same-store results are also improving on a sequential basis with second quarter cash NOI improving 1.4% over Q1. Once again, the improvement we've experienced is very broad-based with 14 of our markets experiencing positive cash same-store growth in the second quarter and nine of those markets showing double-digit improvement. Based on these results, we are increasing our projections for the full-year of 2012 same-store growth to 4% to 6% on a cash basis and 2% to 3% on a GAAP basis.

Phil mentioned that our leasing was very strong for the quarter in terms of volume, but I also wanted to point out a couple of other observations as you look deeper into the numbers.

As we've talked about before, one positive development in the leasing markets that doesn't get fully captured in rent growth statistics is the continued improvement in the level of free rent in the markets today. The average release term for the record 5.8 million square feet of leases we signed in the second quarter was 51 months. The average amount of free rent associated with those leases was 1.1 months. This translates into just over one month free for every four years of lease term.

Even if you throw out renewals, although they made up over 60% of our leases during the quarter, the number increases to just one month of free rent for every two years of term. These results, based on a pretty large sample size, are clearly the best statistics we've seen since the recession and are illustrative of the improvement we've seen in the leasing markets over the last several quarters.

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The other statistic I would point out is that we retained just under 75% of our tenants for leases signed during the quarter, despite the two large move outs I mentioned earlier. This contributed to our occupancy staying higher than expected and continued a very strong trend that has seen us retain over 75% of our expiring leases over the last four quarters.

On the capital markets front, we've locked rate of $90 million of senior unsecured notes that are expected to close in September. The interest-only notes are for 10 years with a fixed interest rate of 4.21%. We will use the proceeds of these notes to refund – to fund the repayment of mortgages that have already matured or will mature in 2012, as well as pay down a bit on the revolver.

The execution was interesting on this transaction, as it was essentially a club deal within our existing group of unsecured lenders. I think it reflects the strength of our lender relationships that we were able to execute very efficiently on a transaction with exactly the size and tenure that we wanted and do it under existing terms at what I think is very favorable pricing.

With regard to our capital recycling efforts, Phil described the excellent progress we're making on this front from a real estate perspective. I wanted to delve a little bit deeper into the quantitative aspects of the program. As we first mentioned in conjunction with our initial 2012 guidance, our strategy has been to fund deployment with the proceeds from the sale of non-strategic assets. Since then, we have acquired $94.1 million and commenced construction on $42 million based on total projected cost.

Including these projects, plus expenditures on projects that have not yet begun construction, we've actually spent approximately $44.7 million on development, which brings the total capital deployment to $139 million. Meanwhile, we've generated proceeds of $147.1 million from dispositions, including the $73.1 million sold late in 2011 and including the assets in Houston, which we expect to close in the third quarter.

When you net it all out, we are slightly ahead that is we've raised a little more capital than we've deployed and a little sooner but it's basically been pretty effective in terms of match funding, all very much according to plan. Looking forward, we expect to close on another $25 million to $50 million of acquisitions during the remainder of the year and expect to start construction on additional projects with a total expected cost of between $50 million and $80 million. This would bring acquisitions to roughly $125 million to $150 million and total development starts for the year to between $100 million and $130 million. We have multiple disposition packages already in the market today, which we anticipate we would use to fund this additional deployment activity.

In conclusion, as a result of the strength we've seen in our operating fundamentals combined with the increased levels of deployment and dispositions we've described, we're raising the midpoint of our 2012 funds from operation guidance by $0.005 and narrowing the range from $0.39 to $0.42 per diluted share. While we are clearly mindful of the macroeconomic uncertainties in the world today, we are also very excited about the results we've achieved and the momentum we've generated here at DCT.

With that, I will turn the call back over to Mike for questions. Thank you.

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QUESTION AND ANSWER SECTION

Operator: Thank you, sir. We will now begin the question-and-answer session. [Operator Instructions] The first question we have comes from George Auerbach of ISI Group. Please go ahead.

George D. Auerbach
Analyst, International Strategy & Investment Group, Inc.

Q

Good morning. Phil, you mentioned that you sort of expect the leasing environment to slow down for a bit before picking backup in the back part of the year. So, I guess, is it fair to say that your tone in your message to the field has not changed in terms of your approach to leasing?

Philip L. Hawkins
President & Chief Executive Officer, DCT Industrial Trust, Inc.

A

I'd said, it's fair to say, it hasn't changed much. I'd said, I'm a little more cautious today than I was 30 days ago or 60 days ago. I'm looking at Jeff Phelan, who is – who could probably speak to it even better, the answer is it depends on the market and the submarket and the building probably more than it did even 60 days, 90 days ago. I still believe that we have to be thinking about economic as we lease space and not just be focused on occupancy.

On the other hand, we're in an environment that I know almost anybody's projections is far from rosy and therefore, taking risk off the table in a way that's attractive as opposed to necessarily waiting for the home run also make sense. So it's more of a nuanced mixed message than you might expect, and it's appropriately so because each market is a little bit different.

George D. Auerbach
Analyst, International Strategy & Investment Group, Inc.

Q

Okay. And just as a follow-up on kind of that theme, the Memphis asset. Memphis isn't the strongest market. Can you maybe talk about the leasing activity at the asset that went dark in the second quarter, maybe your early projections for timing to release that space?

Philip L. Hawkins
President & Chief Executive Officer, DCT Industrial Trust, Inc.

A

Not a projection in terms of one building in our operating portfolio, but I'll tell you that Memphis leasing is fairly attractive. That market is doing pretty well and we do have prospects, we're working on, whether we make any of those or not, I don't know. It's too early. It's great that we got Atlanta signed quickly. Atlanta is a market that has really come back. The last cycle back before 2007, 2008, Atlanta frankly didn't really come to life as much as some of the other markets there – regional distribution markets.

And this time around, it really seems to be holding its own and shining a star. So it's – I was encouraged by that and encouraged honestly by leasing in general. Particularly big box space. When I say it's down – obviously, I'd say that it is down, not surprisingly it's the summer and there's things going on as well. There is an election and those who us who live in Colorado or other swings states, believe me we know there is an election going on. But leasing in general has not falling off the cliff and so we've got activity in a lot of our spaces and especially the fees remain the same, especially Class A larger spaces and the Memphis asset is absolutely that. It's a Class A asset and it's a larger space. So we're reasonably optimistic about it.

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Matthew T. Murphy
Chief Financial Officer, Treasurer & Executive VP, DCT Industrial Trust, Inc.

A

One thing I can tell you George is we're not counting on that space leasing for the remainder of the year in terms of the projections.

George D. Auerbach
Analyst, International Strategy & Investment Group, Inc.

Q

Great. That's helpful. Thank you.

Operator: The next question we have comes from Brendan Maiorana of Wells Fargo.

Brendan Maiorana
Analyst, Wells Fargo Advisors LLC

Q

Thanks. Good morning. Matt, so, I was trying to follow your numbers and I hope I got them correctly, but if I think about the dispositions versus the acquisitions and commenced development projects, it seems like in addition to the $35 million or so that you guys are going to get from the Houston sale, there's probably another give or take $100 million of dispositions that are likely over the next few months. Is that right?

Matthew T. Murphy
Chief Financial Officer, Treasurer & Executive VP, DCT Industrial Trust, Inc.

A

Yeah. Well, I think, when you add up the combination of both acquisitions and development starts that we need, I think that's a – that falls within the range of the deployment, which is really what's driving dispositions. There's range on all of those. Our intent is to fund the activity through dispositions. So there is obviously a range of dispositions based on a range of deployment, but you're in the neighborhood for sure.

Brendan Maiorana
Analyst, Wells Fargo Advisors LLC

Q

Sure. So if we kind of look at where you guys are right now from a balance sheet perspective, it looks like based on the numbers that I calculated for the second quarter, your debt-to-EBITDA is somewhere around 7.3 times, 7.4 times, your debt to gross asset value is – total assets is around 50%, is that where you think you can run the company from a long-term perspective or do you think you'll de-lever a bit over time and what would be the mechanisms you think to do that?

Matthew T. Murphy
Chief Financial Officer, Treasurer & Executive VP, DCT Industrial Trust, Inc.

A

Well, I like the most important first question that's a little on the high side in my opinion of where you want to run over time, I mean you need to look at – I think we're probably a little bit lowering terms of leverage, market value leverage of that, but I think your debt-to-EBITDA numbers are pretty close. But I think the most important way to de-lever is through cash flow growth. And so I think based on what we are trying to accomplish both through capital recycling as well as development is to really develop significant cash flow growth. You're also getting obviously a lot of that through the occupancy fundamentals. So I guess that's my answer. I think we're on the high side, I think we're clearly in the middle of the fairway with regard to what our creditors expect and demand, but I think we're on the higher side of where I'd like to be and I think the most important way to improve that is through cash flow growth in our portfolio.

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Philip L. Hawkins
President & Chief Executive Officer, DCT Industrial Trust, Inc.
A

Brendan, this is Phil. I would also add that we've been pretty clear over the last several years that we intend to fund our growth one of two ways or both, one is obviously how we're doing now, which is dispositions and the second is with the appropriate uses of capital we would be willing to issue equity to increase our balance sheet metrics, improve our balance sheet metrics.

We've been very pleased with the disposition market and I've said we've been biased over the recent quarters by the benefits of portfolio repositioning, but obviously in the right circumstances we will reconsider equity and it just hasn't made sense so far for us for a variety of reasons but primarily because of the disposition market and the dispositions has been pretty well matched up with our deployment, which have been one off deals with a fair amount of visibility internally anyway. So that has been quite beneficial with respect to funding it with dispositions, but that we are willing on the right circumstances to issue equity.

Brendan Maiorana
Analyst, Wells Fargo Advisors LLC
Q

Yes. That's a very helpful color. And then just for me and maybe for the other folks on the line as well, can you refresh my memory as to the sort of target range of the leverage, is it – would it be down maybe half a turn on debt-to-EBITDA and maybe down 5% on sort of overall leverage is that kind of fair for a longer term outlook?

Matthew T. Murphy
Chief Financial Officer, Treasurer & Executive VP, DCT Industrial Trust, Inc.
A

Yeah, I think that's right, I think there is three main ways to measure leverage, it's debt-to-EBITDA, it's fixed charge coverage and it's market value leverage. And again, I think we are in very good shape but I would prefer they be – the metrics be slightly better than they are today.

Brendan Maiorana
Analyst, Wells Fargo Advisors LLC
Q

Sure. Okay. Thanks guys.

Operator: Next we have John Stewart, Green Street Advisors.

John J. Stewart
Analyst, Green Street Advisors, Inc.
Q

Thank you. Phil, I was hoping I can get you to comment on the investment sales market, really just speaking to whether you've seen any slowdown there, any movement in cap rates and then broad-brush how that parlays into the plan for the dispositions that you've got on tap?

Philip L. Hawkins
President & Chief Executive Officer, DCT Industrial Trust, Inc.
A

I'd say no change. And if there has been any change, it's been we're responding to even a lower 10-year treasury than three tenure months ago for Class A assets in primary markets. I'd also say probably a little bit of an improvement, although not great, but a little bit of an improvement in stabilized assets in secondary markets. It's a healthy environment out there. It doesn't appear to be any short-term reaction to the summer doldrums that several of us have been talking about in terms of leasing. I think people are looking right through that, given their long-term focus as well as their – the access to cheap debt probably is – and lack of alternatives in terms of their

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equity. So I think that the market has been good and encouraging, I'm not sure if I – you asked another question I may not have picked up on it. So feel free to...

John J. Stewart
Analyst, Green Street Advisors, Inc.

Q

And then to follow through to your disposition program?

Philip L. Hawkins
President & Chief Executive Officer, DCT Industrial Trust, Inc.

A

We are focused on selling assets that from either a location perspective or a functional perspective, or maybe even a just growth perspective, we feel are better off in the hands of somebody else and we can put that capital to better use in other ways that are more strategically consistent with our long-term plans. So what you saw, we saw some economic opportunism by some user sales that we took advantage of and we sold some flex assets in Atlanta that we have had for a long time and honestly aren't very good at.

We're not flex guys and those in my opinion were tough assets in a tough market, but I hope the buyer does well with them. The assets that we looking to sell elsewhere again would be either from a market or locational perspective, we're looking to downsize or from a functional or modeling perspective, we're looking to downsize. We're now looking to sell frankly where everybody else absolutely wants to be, which is Class A fully leased coastal assets, but we are looking to sell assets where we believe there's a market of investors, where more than one, multiple buyers are there to provide some depth to the opportunity and then respond to unsolicited opportunities or other opportunities come to us through users, happy to sell to the user any building we have at the right economics.

John J. Stewart
Analyst, Green Street Advisors, Inc.

Q

That's helpful. Thank you. And then in terms of leasing momentum, I know you said each market is a bit different, you kind of touch on Atlanta and Memphis. But can you give us a sense for where you're seeing changes at the margin, either the – both in terms of the strongest and weakest?

Philip L. Hawkins
President & Chief Executive Officer, DCT Industrial Trust, Inc.

A

Strongest and weakest markets?

John J. Stewart
Analyst, Green Street Advisors, Inc.

Q

Markets from a leasing perspective?

Philip L. Hawkins
President & Chief Executive Officer, DCT Industrial Trust, Inc.

A

I'm not going to – I have a tough time answering the question, because it was such a broad, each market was doing very well in the first and second quarter. And I'd say the slowdown I've talked about, the summer slowdown of new requirements, had also been pretty broad-based. I know, I can let Jeff talk about some of the markets that he is involve. I think Southern California, it still remains pretty good. But honestly in the summer, we had a heck of a good second quarter. And it was a really good second quarter in a lot of markets. And it's way too early being now one month into the third quarter to try to draw any trends that have changed since then. Jeff, do you want add any color in addition for John?

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Jeffrey F. Phelan
National President of Developmnet & Managing Director, West Region, DCT Industrial Trust, Inc. A

Yeah. The only other thing I'd add to John is that we still see consistency in the pressure on the big-box space. In the Inland Empire those vacancies are still very low. All across the U.S. we seem to be having most of our activity on the bigger box space and I think that that trend is continuing. But again as far as segmenting the tenant sizes, I think it's pretty consistent across the board except for the big box users.

John J. Stewart
Analyst, Green Street Advisors, Inc. Q

That's helpful. Thanks, Jeff. And lastly, Phil, could I get your thoughts on Verde and what you see is the read through to your holdings in Mexico?

Philip L. Hawkins
President & Chief Executive Officer, DCT Industrial Trust, Inc. A

I honestly don't know much about Verde. Their land and their focus is on markets that we're not in – as far as I know it. They may have some presence in Monterey, where we do, but we're in the business of leasing space down there, I really don't have a lot of clarity or insight that would be probably that valuable.

John J. Stewart
Analyst, Green Street Advisors, Inc. Q

Any sense for current valuations for your assets in Mexico?

Philip L. Hawkins
President & Chief Executive Officer, DCT Industrial Trust, Inc. A

Well, actually, I'd say, one thing I like – so I'm encouraged about Mexico. And you're well aware is the emergent of what I consider REITs the Fibra act or law whatever it is, that has allowed now one to come public, one was about to come public, maybe, it already did and then you've got a couple of others that are in formation.

That combined with the Mexican pension plans being allowed now to invest in real estate. Those are two very important changes to provide liquidity, because frankly down there the challenge has been liquidity. Not a lot of stuff for sale and not a lot of buyers out there and that appears to be changing. But I think I'll throw a stake in the ground maybe without a lot of data to support it. My sense is that you've got cap rates for quality assets in major markets that are probably, if they're stabilized, low to mid 8s%s on the optimistic end and high 9s% on the upper end of the range. That range is probably shifting down because of recent developments, but way too early to tell.

John J. Stewart
Analyst, Green Street Advisors, Inc. Q

Very helpful. Thank you.

Operator: Next, we have Michael Mueller of JPMorgan.

Michael W. Mueller
Analyst, J.P. Morgan Q

Yeah. Hi. Quick question on the difference between leased and occupied space, I think you said it was 200 basis points and you expect to be north of 93 by the end of the year. The question is, can you talk a little bit about how

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back-end loaded that ramp is for that 200 basis points to come online, should we expect to see some in Q3 or is it really all Q4?

Matthew T. Murphy A
Chief Financial Officer, Treasurer & Executive VP, DCT Industrial Trust, Inc.

Yeah, I think the – Mike, Matt. The leased but not occupied is predominantly third quarter. The remaining roll that we have such that it is, is a little bit more back-end weighted. So, ultimately, you should expect to see the progress sooner rather than later, all else being equal.

Michael W. Mueller Q
Analyst, J.P. Morgan

Okay. So sequentially, you could have somewhere close to a couple hundred basis point pick-up then in Q3?

Matthew T. Murphy A
Chief Financial Officer, Treasurer & Executive VP, DCT Industrial Trust, Inc.

Yeah. That's in the right neighborhood. We've never given occupancy guidance on a quarterly basis, but that's a good interpretation.

Michael W. Mueller Q
Analyst, J.P. Morgan

Okay. And then, Phil, can you just run through markets and just talk about cap rates that you're seeing for some of the U.S. stuff?

Philip L. Hawkins A
President & Chief Executive Officer, DCT Industrial Trust, Inc.

Well, again, not a lot of change, coastal will be – when I say it's kind of all of entire West Coast, low 5%; maybe even in Southern California, just up 5%.

Jeffrey F. Phelan A
National President of Developmnet & Managing Director, West Region, DCT Industrial Trust, Inc.

I think – Michael, this is Jeff. I think one of the interesting things that I've seen for the very first time as it relates to investments is, historically, we've seen a large compression of the cap rates for the buildings that have lower rental rates, take an example, Inland Empire West, buildings were trading at $66, in the high $60 ranges. Today, there is activity going on in the investment market where you're seeing tenants who have higher rental rates. And you would think that the cap rates would be going up, and now the competition for those types of buildings has continued, which is now pushing those per square foot numbers for those buildings into the $80 ranges. So you're seeing, in this particular example, because there are so much capital in the market, the price per square foot for those assets is growing quickly.

Philip L. Hawkins A
President & Chief Executive Officer, DCT Industrial Trust, Inc.

Let's go through some other markets, so you've go coastal, which is Miami, Southern California, Northern California, and Seattle below 5%, with again Southern California probably being below that, but low 5s%. And you get into major non-coastal markets, Chicago is probably still low 6s%. Dallas and Houston, – Dallas and Atlanta probably in the low to mid-6s%. Houston, similar, mid-6s%. Jeff, you...

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Jeffrey F. Phelan
National President of Developmnet & Managing Director, West Region, DCT Industrial Trust, Inc. A

There are examples in Houston today where assets have traded at just below a 6% cap like 5.95%.

Philip L. Hawkins
President & Chief Executive Officer, DCT Industrial Trust, Inc. A

No doubt that Houston has really continued to increase as an importance to investors looking to place industrial money based on the leasing market, there is a lot of interest there and I know, when I was at NAREIT, a lot of investors commented on Houston. A number of them were on recent tours down there and came away very impressive. So, Houston is a new darling.

Then I think, I am probably – I'm sure missing some but I think then you get into second, what I consider, with no insult to anybody, second tier non-coastal markets, Memphis, Columbus, those kinds of markets, I think you're probably in the high 7s%, low 8s%, and again that will be for Class A stabilized assets. The further you get away from primary markets, the wider the spread is when you go down in quality or go up in terms of lease rollover or vacancy.

Michael W. Mueller
Analyst, J.P. Morgan Q

Okay. Great color. Thank you.

Operator: Next, we have a question from Craig Mailman of KeyBanc Capital Markets.

Craig Mailman
Analyst, KeyBanc Capital Markets Q

Good afternoon. Phil, just want to circle back to your comments on leasing in July. Has there been any consistent pattern among either your tenant size or industry that you're seeing sort of the leasing cycle elongate at all?

Philip L. Hawkins
President & Chief Executive Officer, DCT Industrial Trust, Inc. A

No, other than the person who I speak to a lot, who processes all of our of leases, he would say that decision-making has moved out in some cases, maybe even more than just a few cases, but they're all progressing. I don't think there is – again, with three weeks, it's now four weeks into a new quarter, hard really, for me anyway, to draw any kind of helpful insight other than not unexpected and it's fairly broad-based. The larger deals we work on are development pipeline, continue to make good progress and, honestly, that's where a lot of square footage is, and no sign that those have a hiccup to slow down.

Other than that, I think we're just people who are on vacation and doing other things, and probably worried a little bit about what's going on, and let's say, when we're watching the TV about on the ads.

Craig Mailman
Analyst, KeyBanc Capital Markets Q

In the development pipeline, you had mentioned that you guys are working on a couple of bigger leases, could you specify maybe which one of the developments is seeing the best traction?

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Philip L. Hawkins
President & Chief Executive Officer, DCT Industrial Trust, Inc.

A

I'd – we have prospects, good prospects at each of them. There is not one that would flag that is, that I would say, wow, we don't have the activity we hope for. Each building is kind of a little bit different phase of leasing. But I'm encouraged about each of them at this point in time.

Craig Mailman
Analyst, KeyBanc Capital Markets

Q

Okay. That's fair. And then you'd mentioned that you guys are kind of ahead of pace on what the redevelopment plays that you've invested in recently, any magnitude of how much better yields could come in relative to original underwriting on the speedier lease up?

Philip L. Hawkins
President & Chief Executive Officer, DCT Industrial Trust, Inc.

A

One, we don't break it out anyway, it's hard to provide to a benchmark. I would say, we're clearly doing better on a return projections when we bought them. And it's, yeah it's 25, 50 basis points, but in some cases more, some cases right on schedule, but it's otherwise hard for me to kind of compare, so we'd only provide segment reporting in that way.

Jeffrey F. Phelan
National President of Developmnet & Managing Director, West Region, DCT Industrial Trust, Inc.

A

One more thing that I might add to that, Craig is part of the driver of that is that we've been extremely pleased with the construction pricing after we've taken these projects and bid them out to the contractors. We're finding that we're continuing to get discounts to our budgeting, which I think has also been very helpful.

Craig Mailman
Analyst, KeyBanc Capital Markets

Q

Okay. So it's a little bit expense control, little bit better activity?

Jeffrey F. Phelan
National President of Developmnet & Managing Director, West Region, DCT Industrial Trust, Inc.

A

Correct.

Craig Mailman
Analyst, KeyBanc Capital Markets

Q

Okay. And then just lastly for Matt, you guys increased the same store NOI guidance for the balance of the year and first quarter you had 9% and 6% this quarter, just curious as you think about kind of the occupancy uptick versus where rental rates are? Do you think that you guys have enough juice in the tank with comps to keep same store sort of in the 4% plus until we start to see rents really roll positive next year?

Matthew T. Murphy
Chief Financial Officer, Treasurer & Executive VP, DCT Industrial Trust, Inc.

A

Well, there's a lot wrapped up in that. So I think in terms of the trajectory thus far this year into the end of the year, clearly you're seeing the improvement decelerate predominantly as a result of the occupancy that you're comparing against to getting higher through 2011, right. We haven't talked a lot about 2013. I'm not going to start

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here, but I do think ultimately the comparisons on rental rate growth start getting easier as you move forward. The rent roll downs, there's a lot going on, it's obviously the byproduct of what's going on in market rents.

It's also a byproduct of what you're comparing against and we really start getting into the majority of leases that will be signed in 2013 will be compared against post-recession rents. And therefore, you're going to see that metric improve, it's going to move – it's going to be volatile, it's jumpy as hell, because it's so specific. But the trend is clearly continuing favorably. You've seen it play out for our numbers in 2012 and absent of jolt to the system that we're not talking about, hard to believe that tide turns going into 2013.

Craig Mailman
Analyst, KeyBanc Capital Markets Q

Great. Thank you.

Operator: The next question we have comes from Jamie Feldman, Bank of America Merrill Lynch. Please go ahead.

Jamie C. Feldman
Analyst, Merrill Lynch, Pierce, Fenner & Smith, Inc. Q

Great, thank you. I was hoping you guys could help us frame the magnitude of the e-commerce opportunity out there, I mean, we keep hearing from companies and brokers that all of these retailers are thinking about getting your e-commerce strategy right and repositioning their warehouse footprint. Do you have a sense of how big that be and how long that can last?

Jeffrey F. Phelan
National President of Developmnet & Managing Director, West Region, DCT Industrial Trust, Inc. A

Jamie, this is Jeff. It is a consistent conversation that we as an executive group continue to manage and discuss. And I do believe that you're going to find significant growth in not only your core markets, but additional markets due to the surge of the e-commerce. For example, I think there have been examples in Reno, where you've seen e-commerce that has showed up in a marketplace that really is not a market where we're building in today, but e-commerce is going to a location like Reno. So again, I do believe that there is an increase in it, not only in the core markets, but also in the secondary markets.

Philip L. Hawkins
President & Chief Executive Officer, DCT Industrial Trust, Inc. A

And Jamie, this is Phil. Clearly the Amazon factor where in many cases, they are on a build-to-suit basis leasing very large buildings, and not only large in absolute terms but large all through the market. Phoenix is a great example. That's not a segment that we find all that attractive at least assuming not now. We are looking to buy buildings that – and build buildings that will work very well for e-commerce, many e-commerce requirements, but other typical requirements in that market of a size that is deep, rather than trying to play at the fringe of a size and design perspective, that's just not something we consider our strategy, nor necessarily our strength.

Jamie C. Feldman
Analyst, Merrill Lynch, Pierce, Fenner & Smith, Inc. Q

But I guess as I understand if there was this initial wave placing your warehouses based on the tax rules in certain states, and now that it looks like there might be a leveling out of tax rules. They're now – the new focus is just get closer to the end user, and really just align it purely with what makes most sense for the business and logistics. Is that something what you're seeing and how does that affect you?

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Philip L. Hawkins
President & Chief Executive Officer, DCT Industrial Trust, Inc. A

I think we talked about it several quarters ago, we've been thinking about that from a board level. I think we – our view has been that the tax advantage was going to go away. And what we're seeing is that the e-tailing tenants we're going to be more focused on delivery and convenience, really focusing on the same day abilities and that's what's been going on in Amazon's planning for quite some time.

Again, I think if you build really good buildings that work well for a variety of users including e-tailers and especially e-tailers in infill locations you're going to be a – you're going to benefit from that trend rather than again focusing on what was happening. And still is to a certain extend, large gigantic boxes that are just overwhelming in size relative to other buildings in the area and other users that might may come in behind it if they ever – if that particular build-to-suit tenant ever lease. That's the kind of thing we've stayed away from, but folk in really good, convenient locations with great access to local transportation networks as well as regional and national, you're going to do fine. And not try to out think what may be going on out there.

Jamie C. Feldman
Analyst, Merrill Lynch, Pierce, Fenner & Smith, Inc. Q

But it sounds like you're current leasing pipeline gives you guys the confidence is not kind of a one-time trend or a secular shift. It really is just business is kind of getting back to making decision-making in?

Jeffrey F. Phelan
National President of Developmnet & Managing Director, West Region, DCT Industrial Trust, Inc. A

I think that's correct Jamie. Yeah. You are right on and because the other trend that we are seeing is typically – typically, not all the time, those transactions that are being done are build-to-suits. That's what we've seen from a larger tenants like Amazon, even in Southern California those transactions are typically build-to-suits.

Philip L. Hawkins
President & Chief Executive Officer, DCT Industrial Trust, Inc. A

We've had a number of e-commerce tenants including even the lease or two with our friends in Amazon, but not in the unique or special purpose building and nor in unique location, right. Our focus is bread and butter, buildings in bread and butter locations.

Jamie C. Feldman
Analyst, Merrill Lynch, Pierce, Fenner & Smith, Inc. Q

Okay. And then as we think ahead of 2013, it might be a little early to discuss it, but are there known move outs of size that you guys are expecting?

Matthew T. Murphy
Chief Financial Officer, Treasurer & Executive VP, DCT Industrial Trust, Inc. A

Yeah, Jamie. Again we haven't talked about 2013. I would tell you that I don't think there's anything unusual on the roll – there is no concentration in roll, no significant tenants that I am aware of that we have in the course give up on for 2013. But we'd obviously get more into that as we start talking about 2013 guidance.

Jamie C. Feldman
Analyst, Merrill Lynch, Pierce, Fenner & Smith, Inc. Q

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Okay. And then finally a new development in SCLA, which is a place – a market we haven't heard about in a while or development, we haven't heard about in a while. Can you just give us an update on kind of your thoughts there and is that now do you think that will be more active going forward?

Jeffrey F. Phelan
National President of Developmnet & Managing Director, West Region, DCT Industrial Trust, Inc.
A

We are very optimistic about the SCLA project and obviously it obviously is a very long term play for DCT. We've been very successful in the leasing of our speculative buildings in that park and in addition we continue to respond to users looking in the market for build-to-suit transactions. So again we're very upbeat about it Jamie and we're very optimistic.

Jamie C. Feldman
Analyst, Merrill Lynch, Pierce, Fenner & Smith, Inc.
Q

Okay. All right. Thank you.

Jeffrey F. Phelan
National President of Developmnet & Managing Director, West Region, DCT Industrial Trust, Inc.
A

Welcome.

Operator: [Operator Instruction] Our next question comes from Ki Bin Kim of Macquarie.

Ki Bin Kim
Analyst, Macquarie Capital (USA), Inc.
Q

Thanks. I just had a general question. It looks like you guys bought some 100% lease fully stabilized assets in the couple of markets at roughly a 58 cap rate or something similar to that. So my question is, I mean it seems like an off-market deal, it's a term that I just kind of use a lot. But I was wondering if for I guess my own educational purposes, what does that mean and does that mean you actually do get somewhat a discount versus – what kind of discount do you actually get from buying it, off market versus fully marketed?

Jeffrey F. Phelan
National President of Developmnet & Managing Director, West Region, DCT Industrial Trust, Inc.
A

Ki Bin, this is Jeff. How are you?

Ki Bin Kim
Analyst, Macquarie Capital (USA), Inc.
Q

Good.

Jeffrey F. Phelan
National President of Developmnet & Managing Director, West Region, DCT Industrial Trust, Inc.
A

I would say that the majority of the off market transactions that we have sourced have been through the brokerage, brokers and/or directly with the owners in the marketplace. And they don't go to market, so they don't get priced I think at a pace that is non-competitive for us. So, if you're going to ask me why is it and how is it that we're making better spreads on that, I think it's because we're quick to respond, I think we're active in these focus markets with our local teams and able to create relationships not only with the brokers but with the sellers of the buildings as well.

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Ki Bin Kim
Analyst, Macquarie Capital (USA), Inc.
Q

And just a follow-up on that. Does that mean if it was like fully marketed at 5.8% cap and Inland Empire West could have been a 5.5% or I guess how do we – given that's fully stabilized too, I guess I was trying to look at where the value creation aspect of it was?

Jeffrey F. Phelan
National President of Developmnet & Managing Director, West Region, DCT Industrial Trust, Inc.
A

Again every building is different, but I would tell you that we're typically seeing that if they do go to market, and they do get bid up, I would say that there's probably a 50 basis point spread due to that process.

Ki Bin Kim
Analyst, Macquarie Capital (USA), Inc.
Q

Okay. That's helpful. Thank you, guys.

Philip L. Hawkins
President & Chief Executive Officer, DCT Industrial Trust, Inc.
A

The other benefit on this is simply the higher hit rate. It's hard work, but to buy smaller buildings – one-off buildings versus larger portfolios and to be trying to figure out opportunity that we may be able to get in early and preempt results in a higher hit rate, because we have a very low rate, maybe even a zero hit rate, when it comes to fully marketed auctions particularly of larger deals.

Ki Bin Kim
Analyst, Macquarie Capital (USA), Inc.
Q

Okay. Thank you.

Operator: Our next question is a follow-up from Brendan Maiorana of Wells Fargo.

Brendan Maiorana
Analyst, Wells Fargo Advisors LLC
Q

Thanks. So, Phil, you guys sold 550,000 square feet in Atlanta, you talked about that, the flex portfolio, it seems like it's non-core. You're selling 1 million square foot portfolio in Houston. I mean, those are two target markets of yours, end markets, I think you'd like to grow in over time. How much of this non-core assets do you think is within the portfolio?

Philip L. Hawkins
President & Chief Executive Officer, DCT Industrial Trust, Inc.
A

We're always going to find assets where we can redeploy the capital into higher growth opportunities. I think you and others who have seen the Atlanta portfolio, have fully understood, or would have understood, how different they were relative to everything else we have. We own in general a lot of really good assets, the question becomes how do we redeploy the bottom at any point in time of our assets into higher and better opportunities. So I don't think – I'm not sure it's ever a big – it's not a big number, but it's a number that we'll always be working at, always. We'll always be recycling capital.

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Brendan Maiorana
Analyst, Wells Fargo Advisors LLC
Q

So I guess what I'm trying to figure out is if I look at the dispositions in the quarter, the cap rate was low, but the occupancy was low as well. And for those of us that try to model to think about your portfolio from a long-term occupancy perspective, and taking the portfolio today as it stands at 90.2% occupied, and moving that number up to a stabilized level, if you ultimately sell some low occupancy non-core assets, if I strip those out of your portfolio today, does your occupancy move up significantly such that maybe moving to a 94% stabilized level, there's not 400 basis points of upside on the remaining portfolio, maybe it's 200 or something like that?

Philip L. Hawkins
President & Chief Executive Officer, DCT Industrial Trust, Inc.
A

I'm not sure I fully understand the question to be honest. We are 90.2% strips out, what we just sold, right. So I'm not sure...

Brendan Maiorana
Analyst, Wells Fargo Advisors LLC
Q

But how much, what I'm trying to figure out is how much of like assets do you have within the portfolio that are in that 90.2%, that may get sold at low occupancy numbers?

Philip L. Hawkins
President & Chief Executive Officer, DCT Industrial Trust, Inc.
A

Well. Every building we have that's vacant is available for lease or sale at the right economics, every building. We don't own any trophies. So, we can get – now for the right building in right market do I have a preference to own it longer term? Sure. So some buildings, we've got more of an itchy trigger finger on for sale rather than others, but every building is available for lease.

We are trying to maximize economics and we think about it, if we get an to offer that's attractive from an IRR perspective with a tenant offering as a price that we don't think we could duplicate relative to leasing it up to somebody else at current market rents and selling it, even if we aren't planning on selling it, we're going to sell it. Again, I'm not sure we're connecting, we can do it offline, somehow I don't think I answered your question but, we're in the industrial business, we own a lot of buildings, those buildings are always in play, we're trying to manage that portfolio very actively, leasing, selling, buying, renovating, repositioning; and it's always going to be going on continuously.

Brendan Maiorana
Analyst, Wells Fargo Advisors LLC
Q

Yeah. Okay. Maybe we can catch up later but thanks for the color.

Philip L. Hawkins
President & Chief Executive Officer, DCT Industrial Trust, Inc.
A

Yeah I know. Hope I answered a question if not the question.

Brendan Maiorana
Analyst, Wells Fargo Advisors LLC
Q

It's good enough.

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Operator: Next, we have Craig Mailman of KeyBanc Capital Markets.

Craig Mailman
Analyst, KeyBanc Capital Markets

Q

Just one quick follow-up, Matt, what's the free rent in the portfolio now?

Matthew T. Murphy
Chief Financial Officer, Treasurer & Executive VP, DCT Industrial Trust, Inc.

A

$5.7 million.

Craig Mailman
Analyst, KeyBanc Capital Markets

Q

Perfect. Thank you.

Matthew T. Murphy
Chief Financial Officer, Treasurer & Executive VP, DCT Industrial Trust, Inc.

A

$5.7 million, yes

Operator: It appears that we have no further questions at this time, we will go ahead and conclude our question-and-answer session. At this time, I'd like to hand the conference back over to management for any closing remarks.

Philip L. Hawkins
President & Chief Executive Officer, DCT Industrial Trust, Inc.

Thanks. It's Phil Hawkins. Appreciate everyone participating in today's call. We look forward to keeping you updated on our progress as we move forward through the year, and talking again in any day, if not before. Take care.

Operator: We thank you, sir, and to the rest of the management for your time. The conference is now concluded. We thank you all for attending today's presentation. At this time, you may disconnect your lines. Thank you, and have a nice day.

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