DCT Industrial Trust

Third Quarter 2014 Operating Results

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CORPORATE PARTICIPANTS

Melissa Sachs – *Vice President, Corporate Communications and Investor Relations*

Phil Hawkins – *Chief Executive Officer*

Matt Murphy – *Chief Financial Officer*

Mike Ruen – *Managing Director, East Region*

PRESENTATION

Operator
Good morning, and welcome to the DCT Industrial Third Quarter 2014 Earnings conference call. All participants will be in listen-only mode. Should you need assistance, please signal a conference specialist by pressing the * key followed by zero. After today's presentation, there will be an opportunity to ask questions. To ask a question, you may press * then one on your telephone keypad; to withdraw your question, please press * then two. In the interest of equal access to all participants, we ask that you limit your questions to one question with one follow-up. Please note, this event is being recorded.

I would now like to turn the conference over to Melissa Sachs, Vice President, Corporate Communications and Investor Relations. Please go ahead.

Melissa Sachs
Thanks, Denise. Hello, everyone, and thank you for joining DCT Industrial Trust's Third Quarter 2014 Earnings call. Today's call will be led by Phil Hawkins, our Chief Executive Officer, and Matt Murphy, our Chief Financial Officer, who will provide details on the quarter's results and our guidance. Additionally, Mike Ruen, the Managing Director of our East Region will be available to answer questions about the markets, development 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 limitations, 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 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.

Phil Hawkins
Thanks, Melissa, and good morning, everyone. We had another excellent quarter with strong operating performance and active capital deployment and recycling highlighted by the sale of our Columbus portfolio at very attractive pricing. Exiting this market has been a key goal of ours for some time and will allow us to further focus our people and capital in markets where we have a stronger position and are more positive about long-term rent and NOI growth.

The industrial market continues its positive momentum with strong tenant demand and increasing rents. Our operating metrics for the quarter reflect this strength, as well as the efforts of our market teams and active portfolio management. Portfolio occupancy increased 60 basis points to 93.5% and rents on signed leases increased 12.9% on a GAAP basis and 5.7% on a cash basis. As a result of higher occupancy as well as higher rents, same store NOI, excluding termination fees, increased 6.2% on a cash basis and 5.9% on a GAAP basis.

Strong leasing activity has continued thus far into the third quarter with 2.1 million square feet of leases signed as of October 29, including 700,000 square feet of new and expansion leases. Our market teams continue to do an excellent job in leasing space and pushing rents and I couldn't be more pleased with the results of their efforts. We had another active transactions quarter acquiring $180 million, starting $100 million of development and selling $217 million of assets all since June 30.

We are managing to find good quality acquisitions on a one-off basis, although the market remains very competitive. As in the past, our acquisitions continue to be a mix of value-add and stabilized with our primary focus being on quality assets in targeted submarkets that we believe will produce good NOI growth over time. That growth can be achieved through leasing of vacancy, repositioning of the building, favorable in-place contractual rent bumps and/or below market leases that roll in the next few years.

Moving onto development, we started eight buildings since June 30 located in Atlanta, Dallas, Houston, Inland Empire West, Lehigh Valley and Seattle. We signed several leases in our development pipeline during the quarter and have good activity on the balance. We have a number of leases at the LOI or lease negotiation stage that I am optimistic will be signed in the fourth quarter well in advance of our lease-up schedule and at rents that compare favorably to our pro formas. While I am encouraged by the leasing activity, all of us at DCT realize that value is not created by starting a project, but by leasing it.

Consistent with our strategy we fund our acquisitions and development projects on an approximate match-funded basis with a combination of asset and equity sales. Most significantly on the capital-raising front is the recent sale of all our Columbus assets for $112.1 million. Our estimated year one yield on this portfolio is 6.7%, although the brokers are likely to communicate a spot cap rate lower than that. This is obviously a good time to be selling assets and we currently have several additional packages on the market, which we hope will close late in the fourth quarter or early next year assuming pricing is consistent with our expectations.

Lastly, let me make a few comments about our recent announcement of the 1-for-4 reverse stock split. While in academic theory splitting the stock shouldn't matter, in reality and based on a fair amount of investor feedback, it can make a difference. There were three key reasons why we decided on the reverse split. The first is to provide better visibility into per share results, which will be less diluted with fewer shares outstanding. Second is the lower trading costs for many of our shareholders and prospective shareholders. And third is the expectation of lower volatility. We have reviewed several studies and heard from a number of investors that volatility on a percentage basis is much higher in a single-digit stock due to the high impact of high frequency trading. As a result, our board concluded that the 1-for-4 reverse split was the right decision for our shareholders.

In conclusion, this was another very busy and successful quarter for DCT. We are fortunate to be in a healthy market with strong teams of talented people in a high quality portfolio, all of which I believe bodes well for our continued success in the future.

With that, let me turn the call over to Matt, who will provide more color on the quarter, as well as update our 2014 guidance.

Matt Murphy
Thanks Phil and good morning. From a financial perspective, we had an excellent quarter at DCT. All of our key financial metrics were ahead of plan and operating fundamentals remain in very good shape. I will walk through some of the high points.

We increased operating occupancy by 60 basis points during the third quarter ending at 93.5%

occupied; the highest our occupancy has been since the recession. The improvement in occupancy has occurred despite acquiring a little over 4 million square feet through September 30 that was 80.2% occupied and disposing of 2.7 million square feet of lower growth assets that were 96.2% occupied. Further, we ended September with over a million square feet leased, but not yet occupied. We expect that just over 700,000 square feet of these leases will move into our operating pool by year-end and that we will end the year a little above the upper end of our previous occupancy guidance of 94% to 94.5%. In addition to the good news on the occupancy front, rental rates and other leasing stats continued their positive momentum during the quarter.

GAAP re-leasing spreads were a positive 12.9%, including a 15.6% increase on the 1.3 million square feet of new leases signed during the quarter. For the trailing four quarters, GAAP re-leasing spreads have averaged over 13%. Cash re-leasing spreads have also continued their positive trend averaging 5.7% for the third quarter and 5.1% for the trailing four quarters. While the trends in market rental rates throughout our markets remain on a very positive trajectory, a slight dip in rent spreads is possible in the fourth quarter due to a lease signed in October on a 221,000 square foot vacant space in Southern California. The prior lease was signed at the peak of the market in the summer of 2007 and contained healthy 2.5% compounded annual rent bumps. The resulting re-leasing spreads for this lease are a negative 24% on a GAAP basis and 38% on a cash basis.

We are very happy to lease this space to a high credit logistics company and feel good about the economics of the 5-year lease we signed. However, this example shows the potential volatility of the re-leasing spread calculation on a quarter-by-quarter basis. Even in a good building in a very good market, there remains the occasional comp that reminds us we have not yet reached prior peak rents even in some of the markets that were the earliest to recover.

The combination of climbing occupancy and improving real estate rental rates has naturally translated into strong same-store NOI growth. For the quarter, same-store NOI increased 5.9% on a GAAP basis and 6.2% on a cash basis as increasing occupancy, higher re-leasing spreads and over a million dollars of embedded rent bumps all contributed to results ahead of plan. Sequential same-store NOI was 4.3% higher than the second quarter driven by an average occupancy of 50 basis points, embedded rent bumps and a decline in the amount of space in a free rent period. The outperformance of our same-store pool for the quarter, combined with the higher occupancy I discussed earlier, has caused us to raise our full year 2014 same-store NOI growth expectations to 4% to 4.5% on a GAAP basis, up from a previous midpoint of 3.875%. Similarly, we are raising our cash 2014 same-store NOI growth projections to 3.75% to 4.25%, up from a previous midpoint of 3.375%.

From a capital deployment perspective, our market teams continue to find attractive investment opportunities for value-add and stabilized acquisitions and developments. Given the level of activity we have executed thus far this year, combined with our current pipeline, we are increasing acquisition guidance for the year to between $300 million and $350 million. These will continue to be a combination of value-add and stabilized assets although as you can see from more recent transactions, the mix is trending more towards value-add.

With respect to development, we have started construction on approximately $160 million of assets in seven markets thus far in 2014 and may start one additional project of approximately $12 million before year-end. This investment activity continues to be funded with a combination of proceeds from asset sales and the issuance of equity. As we discussed on the last call, our bias has been towards dispositions as evidenced by the $217.3 million of assets sold since June 30. As has been the case for several years, it’s our intention to generally match fund capital deployment with a combination of dispositions and equity, de-levering through growth as I like to say, until such time as we hit our stated credit metric objectives, which are primarily focused today on a debt to EBITDA ratio of 6.5 times. Once we comfortably reach that level, which we expect in the near future, we may add incremental debt on a leverage-neutral basis to fund deployment.

Turning to earnings guidance, we are raising and narrowing our 2014 funds from operations guidance to $1.87 to $1.92 per share. These amounts are obviously converted for the reverse stock split that Phil discussed earlier. This is an increase from the equivalent of $1.84 to $1.92 guidance we issued in the second quarter also adjusted for the split. The improvement in guidance is the direct result of improvement in our operating metrics, somewhat offset by the effects of increased level of asset sales all as outlined above. While we believe our portfolio quality, same store NOI growth and overall cash flow growth potential have been greatly enhanced by these activities, the near-term dilution in occupancy and net operating income associated with buying higher vacancy and selling recently stabilized buildings particularly in conjunction with the deleveraging strategy we have successfully employed, has impacted our FFO per share and will continue to have an impact in the near term.

In summary, this is a good time to be in the industrial real estate business. Market fundamentals are in excellent shape as evidenced by strong net absorption in rental rate growth throughout our markets. Tenant demand continues to be abundant and diversified amongst industries and geographies. And supply, while certainly something that deserves scrutiny, generally appears to be occurring in markets and submarkets that warrant it and at levels that are rational given current demand.

We are well positioned at DCT to capitalize on in this environment. We believe our portfolio is much improved in terms of quality and location and will continue to perform not only in today's excellent market but also if and when industrial fundamentals soften. We believe that our well underwritten willingness to buy vacancy along with our market team's local knowledge and ability to create value through the leasing process will allow us to continue to produce industry-leading same store NOI growth. We have had a good year thus far in 2014 and our third quarter results reflect this. However, at DCT, our focus remains on how we can continue to create value for our shareholders for the remainder of 2014 and beyond.

Before I turn it over for questions, I wanted to point out a typo in the supplemental that we discovered last night. On development overview on page 12 we show the projected completion of DCT White River Corporate Center Phase 1 building in Seattle as the first quarter of 2015, in fact it is slated for completion in the fourth quarter of 2014, sorry for any confusion.

With that, let me turn it back over to Denise for questions. Thank you.

QUESTIONS AND ANSWERS

Operator
Ladies and gentlemen, we will begin the question and answer session. To ask a question, you may press * then one on your telephone keypad. If you are using a speakerphone, please pick up your handset before pressing the keys. If your question has been addressed, you may withdraw from the queue by pressing * then two. Once again, in the interest of equal access to all participants, please limit yourself to one question and one follow-up. If you have further questions, you may re-enter the question queue.

And our first question will come from Kevin Varin of Citi. Please go ahead.

Kevin Varin
Hi, good morning. Can you just walk us through the decision to buy the two large fully leased assets in California and Chicago, maybe just give us more detail on where you expect to drive value at each property just given the asset seems to be fully priced?

Phil Hawkins
Sure. Thanks Kevin. This is Phil. The Northern Cal asset is right next to—right nearby a land site that we have had under control now for a year through contract; we've not closed on it. We are taking it through entitlements and so we will be starting development sometime in the first half of next year, which is obviously subject to the market remaining where we think it is. The asset's a very high quality asset, high quality tenant, 3.6% annual bump, so we are going to see good healthy same store performance of that asset day one. And then we have strong views of that market and a desire to increase our presence in that market, it's Tracy (ph), in the Northern California area.

We like that market a lot and like long-term nature of the asset and owning a Class A asset right next to a building we are going to building made a lot of sense to us. We did buy a core asset on the list that shows as leased, I thought I'd explain, too, which is in Seattle. It shows it 100% leased, but actually and it was technically on closing, but shortly after buying it, as we knew as we counted on, half the tenant vacated. We thought we would be renovating the building and going through a pretty significant redevelopment, but instead have a tenant lined up for that half a space, no half a building, no leases signed, but feel good and so if we lease it we probably will postpone the significant capital outlays that we had thought about.

Chicago, right near a building we developed, a number of other buildings that we had also acquired over time. We've got a strong nucleus there. We have, again, there is good healthy rent bumps in place, below market rents. We had also acquired a building right near there that was under leased, I forget the exact occupancy, but it was, I think, 50% leased or so. So, we are taking vacancy where we can get it.

Maybe a quick comment on why we buy core, because I think that's clearly the question is why buy core at all? And for me, we have a bias towards value-add, but we only get and we have not limited our acquisition of value-add opportunities by some unnatural decision-making process other than thinking about the economics and the asset itself. For us, whether we buy a core asset or a value-added asset, it starts with do we like that asset long-term, is it something we want to own and something we believe because of the market and location and the asset itself will perform well over time for DCT? Will it enhance our portfolio long-term?

And what we look for in a building when we are buying core is there some way to grow that net income stream. It may be below market rents with fairly short-term rollover exposure, rent bumps I've already mentioned about maybe in some cases they show up as full, but we think re-tenanting or renovating or somehow repositioning the building up on roll [ph] and it may not be tomorrow, but at some point in our whole period we think will result in an increasing value and good growth in NOI over time.

And lastly, I would say the reason to buy core is we have a dividend to cover and interest expenses to cover and people really want to see a strong balance sheet; EBITDA is important and so cash flow is important. Our average occupancy on acquisitions was 77% this quarter, but actually, it's a little lower than that as I mentioned because of the Seattle building. So, we are not buying all vacancy, but we also are mindful of the fact that we are trying to buy good mix of good quality assets that generate good quality cash flow growth. Long answer, sorry, but I know it's a question on many people's minds, I have certainly heard it over the last several quarters and I am happy to talk further about it now or offline as well.

Kevin Varin
It's helpful. And then just one follow-up, Matt, there is a sizable floating rate term loan on the balance sheet, I think it's $225 million due in 2018. Do you think about swapping to fix or maybe even prepaying that debt to minimize the interest rate risk?

Matt Murphy
Well, as you could see, I mean, we have over the last couple of years significantly decreased our exposure to floating rate debt. I think as a seller of assets as we have been, it's important to have some measure of floating rate debt on the balance sheet. It's high-teens from a percentage of total debt. I would not be the least bit surprised to see part of that be the use of proceeds of a potential future bond deal.

So, I think first of all, we are very conscious of making sure that we have average maturities and laddered maturities that prevent us from being overexposed to interest rates at any one given period of time. I think it's appropriate for somebody that is as involved in asset recycling, as we are to have some pre-payable debt. So, you are at no time sitting on cash on the balance sheet. And I do think it provides flexibility for future capital markets transactions. So, it's out there intentionally. Your point is well taken, but I think we do a pretty good job of mitigating interest rate risk sort of in other facets.

Kevin Varin
Okay, thanks.

Operator
The next question will come from Gabe Hilmoe of ISI Group. Please go ahead.

Gabe Hilmoe
Thanks. Good morning, guys. Phil, just going back to your comments on the LOIs that are out for signature on the development leasing, any way you can kind of put some fence posts around the level of that volume, maybe that you are feeling really good about versus maybe what's still a bit more speculative that's still in the works? I know the deals don't count until they're signed, but just trying to get a sense for what the pipeline looks like given a pretty significant amount of product coming online in the next six months?

Phil Hawkins
Yes. I'd rather not for lot of different reasons ranging—the leasing activity ranges from exchanging of LOIs, to signed LOIs, to leases out for negotiation, more of it frankly, the former than the latter, but strong activity that I feel good about on every one of our buildings. Some of them that we just started construction on, it's a little early, but even on some of those, we have got serious proposal activity that is encouraging. In my opinion and I know a lot of our employees are listening, the most important thing we can do between now and the end of the next call is put some leases on the board.

Gabe Hilmoe
Okay, fair enough. And then just maybe on the cash renewal spreads, obviously been trending positive throughout the year. I think they are running 5%-ish year-to-date, but when you look at

the roll coming next year, Phil and I know there can be some choppiness quarter-to-quarter like you'll see with the lease in California, but how do you see that number trending into next year? Do you think it accelerates from where it's been trending in '14?

Phil Hawkins
I am going to let Matt answer with facts, but I will give a quick conceptual comment, which is I think next year sets up well like it does this year. Mix will be important of both age or vintage and market, but overall I think we set up well. Matt, you want to either confirm or deny that?

Matt Murphy
Well, I appreciate the confidence, but what the re-leasing spreads next year I am not going to answer with facts yet, but what I can say is I do think 2015 really the next 15, 18 months, the comps are probably as favorable as they are going to be. Ninety percent of the leases that expire in that period were signed post-recession. I think even more important than that is roughly 50%, a little bit less than 50% of that was signed before 1/1/11, which I sort of think of as an arbitrary point at which economic started at least coming back in our direction.

Longwinded way of saying I think the comps for the next set of renewals are going to be as favorable as we have seen. You combine that with the idea that market rents continue to improve in all of our markets. It just got to set up for a good re-leasing spread trajectory for the next multiple quarters in a row. We are not getting into '15 guidance anyway. Even when we do get into '15 guidance, I am not going to give you spot predictions, because as I just talked about in my comments, it's a pretty volatile individual calculation, but both the trend lines in terms of what's going on in the market and the comps that are the more factual part that Phil is referring to, all bode very well.

Gabe Hilmoe
Okay, great. Thank you.

Operator
The next question will come from the Eric Frankel of Green Street Advisors. Please go ahead.

Eric Frankel
Thank you very much. Could you comment on the activity, the leasing activity levels in Houston? Obviously with oil prices dipping down a little bit over the last few months, there has always been a little bit of a concern that it's an oil dependent economy and obviously, you are taking a little bit more risk with some of your recent value-add acquisitions and your developments as well. So, maybe just want to get your comment on what demand you are seeing right now and the threats of demand decreasing in the future if oil prices continue to plummet?

Phil Hawkins
That's a—I don't want to say they continue to plummet, but they certainly are down. That's a broad question, but I think an excellent one. The activity in Houston, as of now, is outstanding. Demand, it remains very active. Eric, I think it's way too early—it's too early still to gauge what if impact, if any, $80 oil has had on demand versus $100 oil. I will come back to that in a second.

Quick update on the building, so we bought essentially three buildings, two locations, two projects. We bought a 98,000 foot building on the north loop. We bought it vacant, but we actually had a tenant in our pocket, not necessarily a lease signed, but we were pretty darn confident. We then—that we bought the building, closed on the deal, closed on the lease and then the tenant got which would be good credit, but local credit, was bought by Bridgestone. So, not only we were good, butwe got lucky, which always helps. Ten-year deal, I mean, it just—Justin rang the bell with that deal. We converted the building as a renovation, we converted the ESFR sprinklers, and we just upgraded the building. It's a great location and we made the building better.

The two vacant buildings we bought, actually they're newly completed shells, completed by a local developer whose money really was made on the land, really didn't have the—maybe the heart or maybe even the expertise or the capital to lease it. We bought it at what we thought was a good price. We now have about 178,000 feet. We have leases out. We have an existing customer for 50,000 feet and really good activity on the balance. I mean, the rest of our portfolio goes well development—the development that we have underway is leasing well. They are multi-tenant buildings, so it's one at a time; it's not like a big box in California, where you get one big lease to celebrate, but they—Justin, Will, and our whole team down there is doing a great job.

I read the article in The Journal yesterday knowing that we may get this question. I am a little skeptical about The Journal's claim that or the people at least interviewed that production efforts, exploration and production won't be impacted until oil hits $50. I got to believe a lower oil price, an $80 versus $100 has to have some impact on at least the growth rate, maybe not making it negative, but at least the growth rate.

There are couple of things though that mitigate, I am not sure offset, but mitigate the impact on our business to watch and we will learn. First is a lot of the demand we see in Houston is really consumption driven, which is based on population growth. Now, that population growth may slow if job growth slows, etc., but that's going to take a long time to unwind and slow down. And in the meantime, those rooftops that are being built and the people that are flooding in need to eat and need to buy various things. So, I think that's one thing to consider. And the other is Houston area has got a pretty significant and growing petrochemicals business, basically the use of energy, natural gas primarily, but also oil as a feedstock in the various products. They are building refineries, they are building plants and that's creating construction jobs; it's creating obviously operating jobs and that in some ways is helped by lower energy costs. So, who knows how it all sorts out? I am still worried about Houston. I watch it closely, because of the supply, which now is pretty much in balance with demand, but every quarter that I worry about it, I am pleasantly surprised in the rearview mirror with how well it continues to go.

Eric Frankel
Thanks for the really thoughtful response. A really quick follow-up on Houston, do you feel like rents are just now keeping up at inflation or is it going at a faster or slower pace in your estimation?

Phil Hawkins
I am not sure what inflation is. I'd say rent growth has slowed. I think it's kind of now low single-digits as opposed to mid to high single-digits like some other markets it's moving up with land costs and construction costs, which are moving up. Construction costs, I am not sure about Houston in particular, but you are probably looking at 3% to 5% in construction costs across the country. Land prices are going up faster than that. That creates a ceiling that rises and rents are moving with that. It's a very healthy market. There is not any signs of sort of oversupply. Vacancies are low. So, from that perspective, it's going well.

Eric Frankel
Thanks very much. I will just jump back in the queue.

Phil Hawkins
Okay, thanks.

Operator
And our next question will come from Brendan Maiorana of Wells Fargo. Please go ahead.

Brendan Maiorana
Thanks. Good morning. Matt, so your occupancy is going to be up over 94.5% by the end of the year and I think if I did the math correctly, your same-store growth in Q4 is probably likely to be kind of plus 7% or something like that to get to the midpoint of your revised guidance, is that right?

Matt Murphy
I haven't checked your math, but it sounds about right.

Brendan Maiorana
Okay. So, just kind of—is there anything from you talked about kind of the rent spreads being very favorable as we look or at least the expired rents being very favorable as we go out into next year. Is there anything to be concerned about from an occupancy standpoint as we progress from the high levels that you'll get to by year end, any sort of big known move-outs that are out there or anything that is likely to cause the occupancy progression which has been good to kind of move off trajectory?

Matt Murphy
We don't have anything really significant from a known move-out perspective. Quite honestly, the biggest one we had we just sold. It was in Columbus, 350,000 square feet, which frankly I wasn't looking forward to getting that one back. There is a couple 100,000 square footers that are 99% sure to move out in the first quarter. We've got a fair amount of exposure in the first quarter, including one 200,000 square footer that is moving out in, sorry I don't have the sheet in front of me, in January that I think is likely, but I still think from a retention perspective, I expect our numbers to be good.

It's obviously if you are worried about occupancy, you are either worried about the front door or the back door. I am not worried about the front door given the level of demand and activity that's out there. And I don't see anything significant in terms of where our guys have thrown in the towel in terms of people moving out. So, again, the market is very healthy. I think our portfolio is very good. So, no, I don't see anything I worry about in specific or specifically; you worry about move-ins or move-outs, but nothing specific.

Brendan Maiorana
Does 94.5% feel like a stabilized occupancy number for the portfolio or do you think it can move higher than that?

Matt Murphy
No, it can move higher than that.

Brendan Maiorana
Care to quantify?

Matt Murphy
And it should. No, part of it will be related to I think 95% seems like very achievable. And I think there's no reason this portfolio can't blow by that. Will it sustain above that? There is a whole bunch of other things you got to talk about to get into that, but I see no reason why you can't get in excess of 95% and stay there, not forever.

Brendan Maiorana
Sure. Yes. Okay, great. Thanks for the time.

Matt Murphy
Yep.

Operator
The next question will comes from Craig Mailman of KeyBanc Capital Markets. Please go ahead.

Craig Mailman
Hi guys. Matt, just on that similar line of questions, so if you have more occupancy upside here next year, rents spreads are doing well, what levels should we expect for rent bumps and I guess it's too early for '15 guidance, but is there anything that you see is a big risk to further acceleration same store is as we trend into '15?

Matt Murphy
No, I don't think, again, that's sort of all the same factors I just went into. I think from a rent bump perspective, it's interesting because the vast majority of leases unless there is something squirrely for some reason generally going to be on the tenant side, bumps are either going to be—we still have what's always in excess of 90% of our leases have bumps. If you're looking for leases that are more than two years in duration the number is probably 95% or 96%. And the vast majority of those have 2% bumps, well recently, have 2% bumps, 2.5% bumps or 3% bumps. You will occasionally see them above that or below that, but they are almost always in that case on an annual basis.

What's really happening is two years ago, the vast majority was 2%, a year ago the large majority was 2.5% and now what you are seeing is an awful lot of 3%s, a lot of 2.5%s and very little 2%s. And so, I don't see anything that changes that trend. I don't have a crystal ball that tells me exactly how that's going to work in leases going forward, but I still, I see no reason to assume a deceleration or certainly an erosion of that in the markets looking forward. We will get into the details of 2015 guidance. We are going through that process right now. We have far fewer spaces in play, which makes the process somewhat easier. But, so I am really talking about fundamentals and there is no cracking going on in fundamentals at all.

Craig Mailman
Just a follow-up to that, though, so you guys are—and you and everyone else seems to be pushing rent bumps pretty aggressively and I know supply is still in good shape in a lot of markets. But at a certain point, does that dynamic sort of limit the amount of market rent growth there can be or are tenants just eating that bump?

Phil Hawkins
This is Phil; I don't think rents are going to continue to grow at high-single digit paces, that's not our business. But we certainly have some runway in front of us as we get back to rents that are

closer and more rational relative to costs. So I think we have got some run room where we have above average rent growth but we will be selling down if, and hopefully, the sector remains stable. We will still be slowing down rent growth, market rent growth but that still gives you some runway over the next 18 months, as Matt mentioned, for what we think is a healthy rent spread environment, rolling off all the leases subject to of course the whims of volatility of mix.

Craig Mailman
Okay. And then just one last quick one, Matt the free rent component, I guess since really 4Q of '13 has been trending higher; it's still right around that $10 million mark. Is there anything going on with that, should we expect that to kind of turn back lower?

Matt Murphy
Well, I think the simple answer to that is the leasing in the development pipeline that's been done sort of in our first wave of development, those are big spaces. Those were big spaces; the ones in California have. You are going to—one of the interesting dynamics when you are developing big-box spaces as you are enticing large tenants to move. Those guys don't move over the weekend; it takes many months to get them up and running and so you tend to see a higher level of free rent associated with those big spaces. And when those happen, first of all, that $10 million probably the most important thing to mention is that $10 million is an annualized number, not how much free rent we are actually intending to give. It's part of the property table that's used to sort of annualize the amounts in order to help people figure out NAVs. I didn't actually run the calculation in the third quarter, but in the second quarter the number that was quite a bit higher than that, it was only like $1.4 million of actual free rent that was still to be given, the annualizaiton makes that a little bit—deceptive is not the right word, but it overstates the number.

Craig Mailman
Okay, great. Thank you.

Operator
The next question will come from Emil Shalmiyev of JPMorgan. Please go ahead.

Emil Shalmiyev
Hi, good morning. For your current pipeline, how much time are you kind of expecting for lease up and it seems like in Q1 of '15 a lot of them are coming online, what do you think the average occupancy is going to be for those projects?

Phil Hawkins
Our average—we got the average, every deal we have got that I aware of has 12 months of lease up after completion of construction.

Matt Murphy
Another way to say that is if it's greater than zero on those it will be better than what pro forma is.

Phil Hawkins
We have averaged less than that. In fact every building but one, we have come in quite a bit shorter than that, the one being DCT 55 in Chicago, although the yields there were higher than pro forma, because of the higher rents. So, it's not impossible to miss the 12 months, but hopefully we will do better, but I wouldn't predict it.

Emil Shalmiyev
Okay and how have your conversations early on been going for those, for the newer starts?

Phil Hawkins
Like I said—I think my comments I made on a question earlier, leasing is good. We got them over the goal line. The trouble when you have buildings that are even still under construction, there is no urgency. It is not like the tenant can move in tomorrow, so there is no urgency. There is on our part, but it takes two. I feel good about it and I said I am optimistic that we will have some leases to announce on the next call in early February, but only time will tell if we actually can deliver the real results that we are hoping for.

Emil Shalmiyev
Okay. Thank you.

Operator
And once again, to ask a question, you may press * then one. The next question will come from Stan Fediuk of SunTrust Robinson Humphrey. Please go ahead.

Stan Fediuk
Hi. Thank you for taking my question. Regarding low occupancy acquisitions, are these mostly off market deals and do you see more competition for these lower occupancy assets going into 2015?

Phil Hawkins
Well, many of them are off-market or limited market, the nature of a transaction like that, typically those that involve significant amount of renovation and development, etc., would be—lends itself to more of a conversation between buyer and seller than a full off marketing process. It—value-add absolutely—it's been competitive now for 12 months. Capital has discovered, not surprisingly, the low vacancy rates, high demand and higher yield associated with value-add just like development. That's why there are more developments on line; it's rational. But and I wish that there wasn't any capital, but absolutely there is competition everywhere. There is no easy segment of our business right now when it comes to finding quality assets.

Stan Fediuk
Okay. Thank you.

Operator
The next question will come from Eric Frankel of Green Street Advisors. Please go ahead.

Eric Frankel
Thanks. I am not sure if we ever discussed all the investor activity, obviously you guys are such an active seller of assets, you have such a good window into who are the prospective buyers out there, can you give us a little bit more color on the buyer pool now and how it's changed over the last, call it 12 months?

Phil Hawkins
What's most impressive to me and we sold a number of Midwest assets, Cincinnati and Columbus, and actually sold the Cincinnati assets and Columbus asset in the past. The emergence of the advisors, pension fund advisors as a really active buyer is there, markets that they would never have thought about or considered in '07, when things were good. I think there is a confidence in a broad base and fairly extended length of recovery here as well as a

practical consideration of they just can't get yields in the primary markets that they'd like. And you are still getting paid for secondary market risk.

Clearly, we did announce the buyer for Columbus, the kind of dedicated industrial funds. These are smart buyers, they are active, they have got plenty of capital, they remain active, Exidor [ph] but also others like Exidor, are there. I guess those would be—I can't say what we are selling. I can't say we have got a complete window, because we are not selling coastal core. We are selling Midwest or at least non-coastal, primarily assets. The last thing I would say is users. While it's probably smaller buildings and smaller dollars in general, users are as active as ever. They are always out there in some way in our business even during all types of cycles, but the users have been and it's always a pleasant surprise when a user lobs in a bid at a number that gets your attention.

Eric Frankel
Great, thanks. Final question, I am not sure this has been discussed much, but apparently the ports of LA and Long Beach have pretty big ship backlogs or just having a lot of—they are just having a really hard time I guess via shortage of chassis, they're having a hard time getting cargo through. Is that affecting supply chains at all by your estimation and demand as an after effect?

Phil Hawkins
I think all the ports are busy. I have followed that and it is a chassis challenge. The ports, I think, it's hopefully being awake—as well as a labor issue that all the ports are dealing with as they renegotiate the labor contracts. I think there is a little bit of a work slowdown going in there. Even though it's not necessarily called that, my understanding is that's part of it. It hasn't seemed to affect the demand yet and hopefully never in the Inland Empire, which is clearly the—would feel the heartbeat of LA and Long Beach ports, but certainly something to be thinking about over time.

Eric Frankel
Okay, thank you.

Operator
The next question will be from Brendan Maiorana of Wells Fargo. Please go ahead.

Brendan Maiorana
Hey, guys. So, the anticipated yield that you guys report is that based on just occupancy moving to a stabilized level or does that include if rents are below market at a given asset bringing rents in the property up to market as well, so that would be sort of a longer term fully stabilized yield?

Phil Hawkins
Are you talking about value-add acquisitions as opposed to development, right?

Brendan Maiorana
Well, yes, I am just trying to figure your anticipated yield on your acquisitions is 6-1. So, I am just wondering if that's just bringing occupancy up or if that's got the rent moves in there as well?

Phil Hawkins
Right. Yes, only it takes current leases in place and that's it. No adjustment for below market

rents plus occupancy to a stabilized level at current market rents and then the denominator is increased for the capital associated with not only the TIs and commissions, but any building renovations and maintenance upgrades that are part of that initial stabilization period. So, we adjust both the numerator and the denominator, the occupancy and the cost of that leasing it, but not marking to market any rents that are already in place.

Brendan Maiorana
Right. Okay, so I guess is it fair to say that you think that that 6-1 as leases rollover probably moves higher given that I would suspect that these deals—that the in-place rents are probably on average below market for the stuff that you are buying?

Phil Hawkins
It's a safe assumption and go back to my comments, why we buy any asset, core and I had meant it with respect to core, but also applies to value-add is we are looking for consistent long-term growth. We are not looking for some quick pop. Frankly, if it had a quick pop and nothing else, we would sell it and we are not a merchant buyer. So, we wouldn't do that kind of a deal. So, it's absolutely something we believe over time because of the market, supply constraints, rental dynamics, building repositioning, re-tenanting whatever that applies to a value-add and/or as well as to a core asset, we are mindful of NOI growth over time.

Brendan Maiorana
Yes. So, Phil as—and I heard your comments earlier about kind of the strategy and the buildings and the fit within the portfolio and I certainly think that all of that makes a lot of sense. How do you think about where we are in the cycle and where prices are? And as the yields move down, right, there is a little less kind of wiggle room from a basis point spread perspective, if your target was a 20% kind of value creation or something like that. So, how do you think about the deployment of capital and the yields that you are looking at, at this point in the cycle? And do you feel like maybe it's becoming more challenging and maybe you will pull back a little bit in terms of deployment of capital given where prices are for both for acquisitions and for development?

Phil Hawkins
Two thoughts. First, deals are tougher and tougher. We have turned down more deals in the last quarter than probably in the prior four years. The debate—and every deal takes longer and we have not had a short investment committee discussion on any investment, I can think of for a long time. So, clearly that reflects an environment where we're either not seeing a premium for the risk or we aren't seeing an absolute return that we think warrants our efforts. However, also say we are funding this with dispositions and those cap rates have come down. And in fact, the spread between the markets we are selling in, typically Midwest, and what we are buying in, primary and certainly some coastal, has narrowed.

I will give you an example. As you know, we sold our first tranche of Columbus assets 18 months ago; same measurement in terms of year one projected cash yield was 8.1%, today 6.7%. So, clearly that has an impact in our thinking as well. We don't think it's appropriate or desirable to shrink the company. That would be another question, okay, sell, but don't buy, but that wreks havoc on a number of different areas of the company. We don't believe it's the right time for this company to shrink; it's the right time to grow. I wish we could sell at the same cap rates or lower and buy at higher cap rates, but that's not the environment we are in. So, it's a constant tension that we are debating more actively now and painfully so in some cases than ever before, but we will continue to buy where we think — it may be a close call — but where we think it's the right move for the company economically and from a portfolio perspective.

Brendan Maiorana
Okay, great. Thanks a lot.

CONCLUSION

Operator
And ladies and gentlemen, this will conclude our question and answer session. I would like to turn the conference back over to Phil Hawkins for his closing remarks.

Phil Hawkins
Well, great. Thanks everybody for joining. Happy Halloween and we will see many of you I know next week. Look forward to further conversations. Bye-bye.

Operator
Ladies and gentlemen, the conference has now concluded. We thank you for attending today's presentation. You may now disconnect your lines.