DCT Industrial Trust Inc.

Third Quarter 2016 Earnings Conference Call

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CORPORATE PARTICIPANTS

Phil Hawkins, *President and Chief Executive Officer*

Matt Murphy, *Chief Financial Officer*

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

Neil Doyle, *Managing Director, Central Region*

PRESENTATION

Operator
Good day and welcome to the DCT Industrial Third Quarter 2016 Earnings Conference Call. All participants will be in listen-only mode. Should you need assistance, please signal a conference specialist by pressing the star key followed by zero. After today's presentation, there will be an opportunity to ask questions. To ask a question, you may press star, then 1 on your touchtone phone. To withdraw your question, please press star, then 2. Please note this event is being recorded.

I would now like to turn the conference over to Melissa Sachs. Please go ahead.

Melissa Sachs
Thanks, Amy. Hello, everyone, and thank you for joining DCT Industrial Trust's Third Quarter 2016 Earnings Call. Today's call will be held by Phil Hawkins, our President and Chief Executive Officer, and Matt Murphy, our Chief Financial Officer, who will provide details on the quarter's results and our updated guidance. Additionally, Neil Doyle, our Managing Director of the Central Region, will be available to answer questions about the market development and our other real estate activities.

Before I turn the call over to Phil, I'd 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 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 site at dctindustrial.com.

And now I will turn the call over to Phil.

Phil Hawkins
Hey, good morning, everyone, and thanks for joining our call today. We had a very strong third quarter as both our portfolio and the leasing markets continue to outperform our initial expectations for the year. Our consolidated operating occupancy increased 60 basis points, to 96.2 percent, straight-line rent spreads increased 16.8 percent, and cash same-store NOI increased 9.6 percent. Based on these results and our confidence in the current market environment, we've increased our operating and financial guidance for the year, and Matt will go into detail on that shortly. Our Board also approved an increase of 2 cents per share in our quarterly dividend, a 7 percent increase.

Development leasing continues to track well ahead of our underwriting. We stabilized two projects in the third quarter with a projected investment of $48 million, a yield of 7.4 percent, and an estimated value creation margin of 32 percent. We signed 900,000 square feet of development leases since June 30 and have excellent leasing activity on each of our development projects. Our current pipeline is now comprised of 13 projects, with an expected investment of $303 million, a yield of 7.6 percent, and is 40 percent leased. Our list of future projects also looks strong. In addition to land we already own, we have a number of very well located sites under contract going through due diligence and the entitlement process.

Next month will mark the tenth anniversary of DCT's IPO, which took place on December 13, 2006. To commemorate this milestone, we are scheduled to ring the closing bell at the New York Stock Exchange on Tuesday, December 13. The time has gone by fast, and much has changed at DCT since our IPO, but our company's strategy has remained consistent since we went public. We are committed to creating value for shareholders by being the best owners, operators, and developers of industrial real estate in the United States. We have built a great market centric organization, and it's highly focused on building relationships, aggressively operating our portfolio, and creating value through development, redevelopment, and smart acquisitions.

Over the past ten years, we have completely repositioned our portfolio, selling $1.8 billion of assets, acquiring $1.9 billion, and developing $1.1 billion. We have exited 13 markets to better focus our people and our capital on what we consider to be the best long-term distribution markets in the United States. As a result, 61 percent of our assets are new to the company since our IPO, quite a transformation and one that has produced strong operating and financial results.

Looking forward, the strategic principles that have served us so well over the past ten years will continue to guide us in the future — strong market teams focused on serving our customers and creating value for our shareholders, active portfolio management focused on continuously improving the quality and cash flow growth potential of our assets, and a strong balance sheet that gives us the capacity and strength to pursue new opportunities as well as withstand any economic downturn that we may face in the future. We are fortunate to be in a good market environment, and DCT is well positioned to capitalize on and benefit from the many positive trends impacting our business. Given strong customer demand and supply that remains in reasonable balance, this is definitely a good time to be an owner and developer of high-quality, well-located distribution space in the U.S.

With that, let me now turn the call over to Matt, who will provide more detail on our third quarter results and our outlook for the balance of the year. Matt?

Matt Murphy
Thanks, Phil, and good morning, everyone. The third quarter of 2016 was an exceptional one at DCT. Our financial results, operating metrics, and investment momentum reflect a business with historically good fundamentals as well as an organization that is truly hitting on all cylinders. I'll take you through some of the highlights.

Funds from operations as adjusted was 60 cents per share in Q3, driven by a 60 basis point increase in operating occupancy and continued acceleration in rental rates, both of which contributed better than expected same-store NOI growth. Bottom line results were also aided by a one-time $2.5 million casualty gain; however, even without the impact of the casualty gain, FFO per share would have increased by over 15 percent compared with 2015 as our same-store portfolio keeps producing significant growth, and the development leasing we accomplished in late 2015 and early 2016 has now turned into NOI.

Leasing results also continue to impress and surprise to the upside, with strong numbers in terms of volume, retention, concessions, and releasing spreads during the quarter. Rent growth on signed leases averaged 16.8 percent for the quarter on a straight-line basis and 5.6 percent on a cash basis and has averaged over 20 percent on a straight-line basis and 8 percent on a cash basis over the past 12 months. Leasing activity has been broad based in terms of markets, size, and industries. All of this leasing has pushed occupancy in our operating portfolio to an all-time high of 96.2 percent as of September 30. This number is better than our expectations and positions us very well for the remainder of the year. We now expect year-end occupancy in our operating portfolio to be above 96 percent.

Same-store NOI was very strong for the quarter, posting growth of 8.8 percent on a straight-line basis and 9.6 percent on a cash basis over 2015 as a 130 basis point increase in average occupancy was augmented by $1.3 million of embedded rent bumps, rent growth on new leases of almost $1 million, and a $1.2 million restoration fee. This continued improvement in occupancy and rent growth led us to increase our full year 2016 guidance to a midpoint of 5.7 percent on both a cash and straight-line basis.

It should also be noted that our full year numbers have been influenced by the impending sale of three buildings in Indianapolis, which we expect to close in mid-November. The removal of these assets from the pool will improve 2016 results by approximately 40 basis points, which is now reflected in guidance. This expected future transaction had no impact on third quarter results.

Turning to capital markets, we accessed our ATM program in the third quarter, raising net proceeds of approximately $33.5 million by selling 700,000 shares at an average price of $49.12 per share. This capital will be used to effectively prefund a portion of our development pipeline, and we will continue to evaluate the relative mix of using the ATM and dispositions to fund activities going forward. We will obviously get into much more detail around this when we lay out our 2017 guidance on our fourth quarter call in February.

With respect to full year 2016 guidance, we are raising and narrowing our funds-from-operations guidance to $2.23 to $2.25 per fully diluted share. This increase of 5 cents per share at the midpoint is driven by the non-recurring roughly 2½ cent casualty gain I described earlier as well as third quarter and expected fourth quarter operating outperformance. Some of the key aspects of our guidance are as follows.

As I mentioned earlier, same-store NOI is expected to increase between 5.4 and 5.9 percent for the year on both a cash and straight-line basis. This is up from previous guidance of 4.5 to 5.25 percent on a cash basis and 4.75 to 5.5 percent on a straight-line basis. This translates into predicted growth in the fourth quarter of over 7 percent on both a cash and straight-line basis.

2016 average operating occupancy will be between 95 and 95.75 percent; development starts of $225 [million] to $250 million, up from $175 [million] to $275 million last quarter; acquisitions of $75 [million] to $100 million, and dispositions of $120 [million] to $130 million. For further details, please see the guidance page in our Supplemental.

In closing, I would also like to comment on our upcoming tenth anniversary. As someone who's fortunate enough to have been here since the very beginning, it's incredibly rewarding to see the transformation that has occurred over the past decade at DCT. Part of me thinks it's hard to believe it's been that long, and part of me feels like it's happened almost in the blink of an eye. While I'm very proud of what we've accomplished in the past ten years, what's most exciting to me is that it truly feels like we're just getting started.

With that, I'll turn it over to Amy for questions. Thank you.

QUESTIONS AND ANSWERS

Operator
To ask a question, you may press star, then 1 on your touchtone phone. If you are using a speakerphone, please pick up your handset before pressing the keys. To withdraw your question, please press star, then 2. Please limit yourself to one question and one follow-up. If you have further questions, you may re-enter the question queue.

Our first question is from Manny Kochman at Citi.

Manny Kochman
Hey, good morning, guys. Matt, I hesitate to call these things one-time items, but they are, but they keep creeping up, so if we look out for the rest of ’16 and into ’17, is there anything that’s either expected or in process or just could come out of the woodwork that we should be at least thinking about, if not modeling?

Matt Murphy
No, there aren’t any things in the future. Obviously, I’m not going to get into a whole lot of detail on ’17, but there is no identified transactions like the million dollar — and you’re right, they’re not one-time in nature, but they are intermittent. The casualty gain was clearly a one-time unusual transaction, but there is nothing included in guidance at this point of a similar nature.

Manny Kochman
And, Phil, maybe — maybe a more broad one for you. Things feel pretty good, so what do you worry about? Is it that supply could turn quickly? Is it that demand could shrink, for whatever reason? Just what keeps you up at night?

Phil Hawkins
Well, both those are something to worry about, for sure. It’s more the unpredictable. I think I said the same thing last quarter, maybe even in the last several quarters in a row. We’re in a world that clearly is volatile. We are approaching an election that certainly is interesting, to say the least, and the impact that may have on demand, short-term blips, or longer term is something I think about, because I don't know how to worry — I don’t know how to do anything about it. Supply has ramped up, but it’s ramped up to rational levels, and I still am of the belief that it will remain rational. There may be other markets, there may be some markets where it blips above demand levels for a short period of time, but we’ve seen pretty regularly, pretty consistently that when that does happen, the market itself regulates and those construction numbers come down. So what I really worry about, then, is demand. You know, we’re all building to a rearview mirror, last quarter’s demand, last year’s demand, and so far, that’s actually served us well, because demand continues to outpace expectations, but there may come a day when that’s not the case, and that’s something I would worry about.

By the way, I don’t see it happening. I don’t see it happening. I mean, I don’t see any signs that it’s happening. All the signs we’re seeing are tenant behavior remains strong, decisive. There’s a lot of depth to the demand we’re seeing. As we mentioned, breadth as well is across all industry sectors — size ranges, so there’s plenty of reason to feel really good, which is why there’s reason to worry.

Manny Kochman
And maybe it sounds like it’s also just the way the tenants are approaching decisions. Has that changed at all, whether they’re accelerating or even putting off decisions, or is it just consistent?

Phil Hawkins
I'd say no change. It's hard to say. It's accelerated from where it's been over the last six months, but it's certainly no indication. As we talk to our market leaders, we talk to various customers, brokers, it remains a very healthy environment that has not either accelerated or decelerated in the last six months, from what I could see.

Manny Kochman
Thank you.

Operator
The next question is from John Guinee at Stifel.

John Guinee
Great. You guys are making it look easy here. Wow. A couple of quick comments. Looking at your predevelopment page, you've got a couple of relatively small parcels, 10 and 15 acres in Dallas and Denver, where you seem to be spending a lot of money probably getting it pad ready. Can you talk about those development spends? And then the second thing is what's surprising me is how you're able to still get GAAP yield on costs of greater than 7 percent. Do you expect that to continue, given the escalating in land prices throughout the country? And then the third is the Denver market in your backyard, that's on fire, but you guys haven't done too much. Talk about Denver.

Phil Hawkins
I'm going to forget probably all three — one of those questions, but I'll start in the beginning. The land site in Denver, yes, we are going through entitlement approvals. We got final approvals, not going to start until we get through the winter, so expect to start that project in March or so. It could be April, depending on the weather, but everything is a go at this point. Neil, do you want to comment quickly on Dallas?

Neil Doyle
Sure. Sure. We have a pad site of about 9½ acres in the airport submarket, and that is a parcel — it's adjacent to a couple of buildings we own already, John, and we're going to break ground here probably within about two weeks on a 112,000-square foot building, divisible.

John Guinee
Okay.

Phil Hawkins
In general, I'd say a lot of our developments, John — and others of you may have noticed — are getting smaller, and the reason is I think that's where the market opportunities are emerging as multi-tenant building rents have moved up. They trail behind the big bulk buildings. They moved up. Development opportunities are more interesting, and the supply competition is less. So that's our bread and butter, infill sites close to the airport of Dallas. You know, Denver, so I — anyway.

The second question was yields, and I would expect yields to trend down. Land prices are going up, we try to find land sites that have some problem that needs to be solved, and we're going through a lot of land sites right now, going through entitlements, going through wetlands mitigation, traffic studies,. We're not taking title, but we are spending money on sites and have under control, sites in a number of markets around the country that we're investing in the land development and therefore getting paid for that effort and that risk, which helps keep yields and spreads up relative to some developers that are more focused on pad-ready sites. But I would expect yields to keep coming down. As long as we keep outperforming our leasing, we'll keep doing better than we have underwritten, but we don't project that.

The last question is Denver. It's a nice little market. It's our backyard. It's one of the strongest markets in the country for a variety of different reasons. We actually have a building under contract. I think we waived due diligence and went firm on the deposit this week and hope to close by year end, hopefully actually maybe even sooner than that. I don't expect Denver to ever be a market like a Southern California or Atlanta or Dallas or even South Florida, but it's a nice little market, and we've got a nice little niche that we've been able to build up here.

John Guinee
Great. Thank you very much.

Operator
The next question is from Eric Franklel, Green Street Advisors.

Eric Frankel
Thank you. I just want to follow up on the supply question from earlier. Can you specifically talk about some individual markets where supply pipelines really have picked up in response to pretty much unprecedented demand and detail, well, Dallas certainly already — Chicago and Atlanta, though, are two markets where supplies have really picked up, and obviously you have some developments ongoing there.

Phil Hawkins
Well, the story in Dallas hasn't changed, and, to me, it's a story of both incredibly strong demand, the highest level of net absorption in the country, and it's really tied before it or near the top if it's not exactly at the top and an area where there's a fair amount of construction, both capability of development as well as land. Much of that, as you've heard and many of you know, is on the south side and also in larger boxes. That's not the area we play in. We are focused on infill sties in North Dallas and Northwest Dallas near the airport. As Neil just mentioned on the one set we're working on, we're assembling land, multiple sellers, various whatever challenges, and it's served us well. Frankly, as far as development projects go, Dallas development projects continue to experience one of the highest levels of pre-leasing in our portfolio.

Atlanta is late to the game, so it's early in the recovery. A similar story as Dallas, I've seen a lot of big box construction, as you would expect. A lot of that is in markets that are pretty far out from Atlanta in terms of that supply. It's certainly, like Dallas, something we look at closely, but, again, we have a project under construction with pretty strong pre-leasing activity and feel really good about that. We have another site we're working on and have under contract that we hope to close and, frankly, already have some pre-leasing activity interest, not necessarily leasing, but certainly pre-leasing interest from various well-known users that, hopefully, will turn into something successful, but you never know. Neil, do you want to comment on Chicago?

Neil Doyle
Sure. Eric, as you're aware, Chicago had a — it's not a record third quarter, but it's up there, and it's a little over 8 million square feet of absorption, and so the question is what supply is out there? And if I just take A assets, let's call it 100,000 square feet or greater, there's roughly about 14 million feet vacant from Wisconsin down to Indiana, and if I put the under-construction

on top of that number, I get to about 21 million square feet of A product divisible down to 100. That's a year's run rate, and so I feel we're at a pretty good median. I wouldn't say it's a great situation. I wouldn't say it's a concerning situation, but we're averaging a little over 20 million square feet of absorption the last few years in Chicago, so I'm pretty comfortable.

We'll see what the fourth quarter brings. The third quarter was huge. It was much larger than the first and the second, and I do think there's another trend pushing that, but 50 percent of the absorption in the last two quarters has been either printing packaging, manufacturing, or food, and my experience tells me that those deals can take a little bit more time towards conclusion, just because they're a little more sophisticated buildings. So we'll see what happens here in the fourth, but so far it's been a pretty epic three years in Chicago, and it seems to have gotten stronger very recently.

Eric Frankel
Okay. Final question, is this related to your Cincinnati acquisition, and how you'd like to scale your portfolio going forward, and I think it's fair to say with your portfolio transformation, that you've put greater focus on markets with larger populations, and so I want to understand the Cincinnati acquisition rationale, whether you intend to grow there, especially considering you've done some dispositions there over the last couple of years.

Phil Hawkins
Neil?

Neil Doyle
Sure. Eric, you're right. We have sold significant product in Cincinnati in the last few years, and a lot of that stuff was just low growth, low quality, and I think if you and I walked through the portfolio today, it would probably be a greater percentage change than what Matt talked about earlier as far as the nation goes for DCT. So the portfolio's getting better, and it's getting better through acquisitions like this, so I'll just walk you through real quickly. This was an opportunistic deal in Hamilton, Ohio, 300,000 square feet, well below replacement cost. The value-add was that it was 60 percent leased to a credit tenant long term. The building itself has got all the bells and whistles plus, and when I say plus, we've got 20 foot clear, we've got ESFR, we've got 50 x 50 bay sizes, but, to me, the real selling point was that we're about 22 percent coverage, meaning this building in a mature submarket will have two to three times the amount of trailer parking as any competing high-V building. That is our theory, and based on the activity and the showings we've had in the month since we've owned it, I believe our theory's going to prove out, and that's going to separate us from the pack. So this is a really great buy. It's a simple value-add, it's a great asset in a mature submarket with some advantages that no other buildings have, and I believe that is going to be very accretive to the Cincinnati portfolio.

Phil Hawkins
Eric, I would add, Cincinnati's like Denver. It's a market we like. It's clearly a smaller market, but it has topography barriers to new supply combined with pretty healthy demand drivers — e-commerce, manufacturing, distribution, pretty close hub to Louisville, and also DHL has a hub there, so we like Cincinnati a lot, like I said about Denver, it isn't going to be probably very often on the supplemental in terms of acquisitions, but if we can find something to acquire and/or develop — and our team there is outstanding and they're doing a great job and are working a few development ideas that may — one or two builds-to-suit as well as a few other ideas. If we could find attractive, compelling investment opportunities, we'll pursue it.

Eric Frankel

Okay. Thanks. We'll jump back in the queue.

Operator
The next question is from Rob Simone of Evercore ISI.

Rob Simone
Hi, guys. Morning, thanks for taking the question. With the spread between demand and supply widening out through this year and you guys have obviously moved your development starts guidance up and towards the higher end. I know you haven't provided an outlook for 2017, but is there anything you can share on your view of the world as it relates to starts next year and beyond?

Phil Hawkins
Yes, I'll reiterate what I said in my opening remarks and also maybe repeat what I said last quarter. We've got a good pipeline, and it's not all that visible in terms of our financial statement, because a lot of it is under contract but not closed as we work through various entitlement issues, but I feel really good about that pipeline. I feel better about the pipeline today, this year, than I did last year, a year ago, about our '16 pipeline. I have not thought about guidance, and I suspect we will not try to put ourselves in a box where we have to start projects just simply to meet guidance, but if I was going to take an over/under on'17 starts compared to '16 starts, I would take the over.

Rob Simone
Okay. That's really helpful. Thanks, guys.

Operator
The next question is from Craig Mailman at KeyBanc Capital.

Craig Mailman
Hey, guys. Just curious, you and peers are pushing occupancies here above 96 percent on more of a sustainable basis. I'm just curious on your thoughts of maybe where frictional vacancy is in your portfolio, given the big turnover you've had since the IPO and the push infill and kind of what you guys are seeing as you're thinking about next year — not trying to get guidance but just trying to pick your brain a little bit about how you guys are thinking about where occupancy could be sustained.

Phil Hawkins
I'm not sure frictional vacancy is how I think about it, but, clearly, as you get into the 96es, it gets more difficult to rise from there. It's possible as we've seen a number of our peers hit 97 [percent]. Two things are going on as you do that. One is one or two spaces in our company can make a difference. A 400,000-foot space here, a 500,000-foot space there, and it may be only vacant for six months, but that adds up, and so it gets harder. The second thing is, clearly, as our own occupancy rises and as the market occupancy is also at historical highs, we're pushing rents, and we're less sensitive about pushing occupancy and more sensitive about pushing rents. I'm not trying to be unrealistic about it, but, clearly, now is the time to be really setting rents and pushing rents and not be afraid of a vacancy or losing. And the way to push rents is you're not afraid of losing a deal, and right now I would say in most of our markets, maybe all of our markets, in most of our buildings, we are not afraid of losing a deal.

Craig Mailman

Okay. That's helpful. And maybe as a follow-up, to the pushing rent theme, just bigger picture as your portfolio's evolved, you guys are more infill, more coastal. As you think about how your tenant mix has maybe changed a little bit with more Fortune 500 type companies who have real estate as a percent of their overall cost, much smaller relative to your small business type tenants, how has the conversation trended with your ability to push rents and kind of the pushback you get versus their just need to get space in the place that they need to have it to fulfil their supply chain?

Phil Hawkins
First, no one on the customer's side likes or has an easy conversation about raising rents. We just signed a new lease in Denver, and I know what it feels like, actually, as our rent moved up from probably 50 percent. So I know what it feels like, and it's not easy. I would say bigger tenants, what I call professional tenants, actually are more aware of and professional about the rent environment than smaller tenants. And I don't know this for a fact, I suspect that smaller tenants — real estate's a bigger portion of their bottom line than larger tenants. We still are, even for major global distribution type companies, maybe I'll go with e-commerce, full-time e-commerce companies, real estate is still third or fourth on the list, and they are well capitalized, and we really are a part of the solution, not a part of the problem. We are helping them save money and/or grow their business ad/or shrink the amount of time and/or uncertainty involved in getting product from one source to the ultimate marketplace. So, like I say, I think professional tenants, larger tenants, however you want to describe them, again, no one rolls over on the conversation, but I think that they are more aware of the environment they're in, because they see it multiple times and are seeing it from multiple landlords, multiple markets, they may have lost a deal or two, they won't make that mistake again. There's clearly a demand for space and a need for that space that is not price sensitive, but clearly they are price savvy.

Craig Mailman
Yes. Thank you.

Operator
The next question is from Blaine Heck at Wells Fargo.

Blaine Heck
Well, thanks. Good morning, guys. Maybe for Phil. Sorry if I missed this, but can you just talk about the Southern California acquisition.? It looks like a stabilized 4.3 percent yield, which seems uncharacteristic for you guys. Is there any sort of value-add play there, or what made that purchase attractive to you guys?

Phil Hawkins
Yes, over time. The rents are substantially below market. It's in a submarket where we own a number of buildings just nearby, and so we know the market, not a critical mass sort of a word that comes into mind — so we like the submarket, we like those buildings, they're very similar to what we already own, and we're pretty confident in rent growth. You know, it will take us a couple of years to get to it, but within a couple of years, those leases will be rolling over with good, quality tenants, and a pretty good chance of renewal, but also even if not renewal, we like that space. So the opportunity to grow rents over time, over the next three to five years, is what really brought us to that, along with just a confidence in that submarket.

Blaine Heck

Okay. Got it. And then in looking through some of the leases you guys achieved on the development properties, it struck me that there were a lot of partial building leases, none that were full building, and I think you'd talked a little bit about multi-tenant rents moving up. So is that a conscious effort for you guys, building more warehouses designed for multi-tenant use at this point? And how do the costs between constructing for multi-tenant versus single-tenant compare?

Phil Hawkins
Well, first, every building we've built since I've been here has been designed to be multi-tenant. The larger buildings that we are building certainly ended up going in many cases single-tenant, but even larger buildings like Seattle, our White River project, in Chicago, our I-55 project of a couple of years ago, we multi-tenanted it. What we're building now tends to be 100,000- to 250,000-foot buildings with, obviously, some exceptions on both sides of that range, and they're more likely to be multi-tenant even in the 600,000- to a million -foot building, and that's exactly what we're seeing. That's where the sweet spot on the market is right now. It's the sweet spot of the submarkets we're building in. Dallas is a good example, and we already talked about the buildings we have down there are leasing multi-tenant. We expected that. It's where the market is right now, from what we can tell, but we're happy. If somebody shows up and wants the whole building, and, by the way there are a few examples I can think of right now of leases pending or being worked on that are single-tenant leases, so we're happy to do it. Economically, the rents tend to about offset. We're almost indifferent, you know, you have a little bit more cost to subdivide the building, but you also tend to have a little bit higher rents as well.

Blaine Heck
Okay. That's helpful, and if I can sneak one more in, can you talk about your outlook for Houston, still one of your largest market concentrations with about 9 percent of your annualized rents coming there. What's your updated view on the market at this point? Do you think you're happy with the rest of the properties there? Should we expect the exposure to continue to come down in the future?

Phil Hawkins
Neil, you want to handle that one?

Neil Doyle
Sure. So, Blaine, earlier in the year, we did sell some of our higher-finish assets, and there's no more plan at this point in time, if you look at what's happening down in Houston, you've got really a tale of two cities really based on oil pricing at the moment. Some of the higher-finish buildings, North and Northwest, have suffered a bit with oil and gas companies pulling back. The flip side is that eight of the ten top deals done in the third quarter have been down in the Southeast Port submarket. So low oil pricing has really accelerated absorption, and it will accelerate some supply as well down in the Southeast. So that part of the market's doing very, very well. I'd say if there's a middle ground, it's more on the consumer side, and that continues to do, you know, just fine. Vacancy is as good as it's ever been for duration in Houston. Supply has started to equal off to demand, so we're pretty comfortable with our portfolio. It's performing, our role, is reasonable in '17 and even more reasonable in '18, so we'll stay at it. It's not maybe what it was one day, but if you looked over the last 20 years at any market in this country, Houston's doing pretty okay in comparison.

Phil Hawkins

Real quick, it's certainly doing much better than I would have expected or feared two years ago. It's held up pretty well, and I look at our own development pipeline, it took us a little longer to lease, but we're now either fully leased or in one case, have a lease outstanding for signature that we fully expect to get signed, so we'll be fully leased in our development portfolio. Rents are probably down from peak, but they're above our proforma, and so despite a little longer lease-up time, our yields are at or above proforma as well. If that's what Houston looks like, I'm okay with that.

Blaine Heck
All right. That's great color. Thanks, guys.

Operator
The next question is from Michael Mueller at J.P. Morgan.

Michael Mueller
Yes, hi. I was wondering if you could talk a little bit about the acquisitions you closed in the quarter. It sounds like the going-in yield is at 5.4, expected to stabilize at a 6.1. I know you bought one building that had some vacancy in there, but it looks like some of the other ones that are 100 percent leased are in the 7's, and just what's the upside that you're seeing getting up to a 7 in some of those that are 100 percent leased? And if you could just add a little color to that, that would be great.

Phil Hawkins
Well, I'll start with a couple. I've already talked about Southern California, and so I think I'll skip that. Happy to follow up on any questions on that. And then Northern California, it's an interesting story. It's a really small building. It's a FedEx facility. Seller needed to close quickly. We were there. It was an off-market deal. Our guy was in touch with them, and we ended up negotiating a transaction. There's only a couple of years left on that lease, which affects the typical buyer of those facilities, and we love that location. It's irreplaceable from that facility perspective. You couldn't get that kind of zoning. There's no land anyway. It's in San Leandro. We think it's highly likely that FedEx will keep that space, and if they don't, we also like the market for similar type use. It's that last-mile delivery type building, and we love that location, and we think, believe it or not, even with that high yield, we think rents are materially below market. I'll turn it over to Neil. He talked about Cincinnati, which is the partially leased building, but why don't you talk about Chicago, which is the last of the fully leased — Dallas too, I'm sorry, Dallas and Chicago.

Neil Doyle
Yes, we'll touch on both of them. So Taylor Road, Michael, that is right in the heart of the I-55 submarket, obviously not a very large acquisition, but as we alluded to earlier in the call, when you get into these submarkets, and over the last 20 years, I-55 is a great example of cornfields turned to a mature submarket in a period of 20 years, there is very little, if any, land left. You're essentially manufacturing any land today in that submarket. And so when you can find an asset, two things. You're going to find an asset below replacement cost, significantly below replacement cost, and if it's an A asset, we're going to make a move on it. And two is typically when a submarket accelerates that fast, it was done by big boxes, and eventually those big boxes need to be served by smaller boxes, whether it's suppliers and whether it's just smaller feeders to that asset. So I think it's a pretty natural transition, and we were able to come upon this in an off-market deal, and obviously it's not a lot of money, but it's a very solid asset that we're going to hold for a long time.

If I moved over to Commodore Drive in Dallas, and that's in Carrollton where we just developed the Frankford Trade Center last year — but this is a group out of Louisiana that had owned this asset. We purchased the building from them in 2013, we maintained the relationship, it was time for their fund to exit another asset, that asset happened to be next door to a building we already own — I'm sorry, that we just constructed — so we were able to make a good buy on a 30-foot clear Class A building leased to a tenant we know very well, and I think being off market and surety of close allowed us a slightly higher-than-market anticipated yield.

Michael Mueller
Okay. Okay. That's helpful. Thank you.

Operator
The next question is from Tom Lesnick at Capital One.

Tom Lesnick
Hey, guys, good morning. First, I know you've given a fair amount of market color already, but some of your peers have alluded to kind of a bifurcation between Inland Empire West and Inland Empire East, particularly with leasing velocity tailing off on the east side of the market. Just wondering what you're seeing, if there's any color you could add to that.

Phil Hawkins
Well, it sounds a little more dramatic than I would have described it. Our portfolio, both development and existing, is in the Inland Empire West and then also, then, little bit in Orange County and L.A. County, but we don't have a lot of direct experience. My impression is the Inland Empire, both East and West, is doing very well. They can see rates — particularly for large boxes are low, demand is healthy. There's more supply in the East. That's where the land is, and so my impression is it's doing just fine. I don't have any direct experience to offer any additional color than what our peers have already talked about.

Tom Lesnick
All right. That's fair. And then my second one, cap rates seem to have continued to compress a pretty good amount this year, and as you look forward to the next six months to one year out, how does where your stock's trading and where private-asset sales are, how does that change your calculus in how you're thinking about capital sources?

Phil Hawkins
Well, stock prices affect our thinking, if that's the question. Asset prices, though, are still pretty attractive, and we, as Matt already mentioned, we've got some buildings in Indianapolis that are under contract. The buyer's waived due diligence, so we expect those to close in the next couple of weeks. I think we're going to continue to look at capital sources in light of our options as well as, frankly, the use of that capital. It starts with uses first before we can go out and think about raising capital. So I don't know if that answered the question.

Tom Lesnick
No, that's helpful. Thanks, guys. Appreciate it.

Operator
The next question is from Rich Anderson at Mizuho Securities.

Rich Anderson

Okay. Thanks. Good morning. So, Phil, you mentioned over/under. You thought you'd be over in 2017 in terms of development spending versus this year, and then I just want to connect the dots on the pre-leasing percentage. Obviously a lot of moving parts at 40 percent today versus 46 percent last quarter, so what's your floor on that before you can get incrementally more aggressive from a development perspective? Is 40 percent the floor, or are you willing to see the pipeline in its entirety go below that to forward the development effort?

Phil Hawkins
I would not answer that with any definitive statement. We are looking at it on a project-by-project basis. We clearly have identified the opportunity to develop spec, with a willingness to do so. As the cycle's matured, as our company's matured, we have projects at various stages, so in the early days we were at — some people on the call will remember — we were at 8 percent — actually, Matt just said 7 percent — and it worked out great, although we had a call or two where we talked a lot about development leasing. I would prefer to not get back there, and I would doubt we would. I think about it more on a companywide risk management basis. We have said no more than 10 percent of our company's assets at risk in terms of development, unleased development. We have not come anywhere near that. Even when we were at 7 percent, we weren't that close to it, but, nevertheless, I think about it there, when you start a project like we did in Tracy, 700,000 square feet, and you stabilize two buildings in the third quarter, that obviously moves that pre-leasing number around, but we created a lot of value with what we stabilized. We're going to create a lot of value with what's in the pipeline, so I'm comfortable, obviously, with 40. I would be comfortable if that came down a little bit. I hope it doesn't come down a lot more, but if it does, I'll explain our rationale and our thinking at that time.

Rich Anderson
Okay, fair enough. Is there any change to your land strategy? Do you find yourself buying more land at a faster pace today in preparation for next year, or is that not the case?

Phil Hawkins
I'd say no change. Our strategy remains to avoid land banking. We're looking to buy land that we believe is in a market and with economics that we can develop now. And also, we don't wat to get too much land in any one market. We don't want to compete with ourselves, we don't want to get overexposed to a market. Now, Houston is an example where Justin did a great job building and identifying land sites, sourcing them, bringing them in, developing, and then when the market is now going through the oil repricing, we have no land. That, to me, is perfect, and we obviously had a few development projects we had to lease up — they did, and, frankly, we're thrilled that they leased up at yields that were consistent with or better than our proforma. That's still our mindset. As bullish as we are about this business, we are not trying to get too exposed in any one market in terms of the land or development.

Rich Anderson
Okay. Fair enough. Last question on the acquisition front, is there any shift into doing more opportunistic type deals? Do you have a mix of them in your latest activity as a way to counter some of the compression of cap rates and almost give your acquisition pipeline a development effort in disguise? Is that one of the ways you're looking at acquisitions and how that might change in the future?

Phil Hawkins
I'd say we have from almost day one, we've been focused on trying to find value-add acquisitions where the asset was great or we could redevelop it into a great asset, but the

economics also justified the effort and the risk. You know, this market, for all acquisitions, value-add or stabilized, is tough, and so what you've seen that we buy now really has more of a story behind it in terms of the asset itself and the economics over time. We're not going to see huge volumes of acquisitions out of us. I'd be surprised, anyway.

We'll look at things, and we're always talking to people from large portfolios down to small one-off buildings, but I think, given where the economics are and where we are in the cycle, what you see in the third quarter — you saw a little bit more than is normal, but it's pretty typical. Each building had a story. We're associated with that market, that submarket, we own the building next door, or we happen to have a relationship with a seller that needs to move quickly and with certainty. That's going to lead to getting a few deals done. The deal in Denver I mentioned is an off-market transaction where we had a unique relationship that is going to translate into what I think is a pretty interesting deal. It's stabilized; however, if the tenant rolls in the near future, and we're highly confident about that situation, but it's fully leased, the pricing and the risk, though, is reflective of the fact that we could roll that to market pretty quickly. So, anyway, not big volume, not probably a lot of consistency relative to value-add or stabilized. We're just looking for good assets that will generate good growth over time.

Rich Anderson
Perfect. Thanks very much.

Operator
The next question is from Bill Crow at Raymond James.

Bill Crow
Hey, good morning, gentlemen. I think we started this call talking about tenant behavior, and I just wanted to dig into that a little bit more. And, specifically on the e-commerce front, Phil, are you seeing any change in the pace of demand from e-commerce tenants? And then the second part of that is do you get any sense that the expansion might be overdone, too quick, a repeat of the tech scene that we saw in office back in the late '90s, or is everything just booming like it has been over the last couple of years?

Phil Hawkins
Good questions. First, from a demand perspective, clearly e-commerce has a major influence on our business, and, in fact, a major influence even on a lot of our tenants. And I'll give you an example, and it's not a precise number, but we did a survey of our customers, and 30 percent of our customers, whether you do it by ABR or by square footage, say that e-commerce activities represent a portion of the activities in this space, not all of it, clearly some are all of it, some are maybe a smaller percentage. That's a pretty impressive number, which, to me, confirms that you're probably in terms of the actual amount of space, fully dedicated to e-commerce. The estimates of 10, 15, maybe even 20 percent are in the right ballpark. It's clearly an important phenomenon that is without denial.

I know some people are thinking is this a land grab? And that is not, in my opinion, what's going on here. This is a thoughtful, rational perspective. They're trying to meet current demand, and if you look at Amazon, FedEx, UPS, the most obvious full companies really in many ways dedicated to or fully tied to the e-commerce world, they're behind. They're not ahead. They're continuing to ramp up capacity to meet last year's demand and try to get close to this year's demand. Now, if you believe e-commerce is a temporary phenomenon, that's a different answer then. I don't believe so. I think the convenience — what we've seen is e-commerce has moved from people trying to save sales tax, willing to wait a week or two to do so on items — books and electronics are now — books, I think are part of it. Heck, that's all electronic.

We now are focused on rapid speed of delivery, competitive price but not necessarily sales tax benefits, and we've all become, I don't know if all, but many of us, including me, are reliant on e-commerce channels to do a lot of our shopping. Whether you're young or old, and I put myself in the old category, I think it's a convenience and that is hard to imagine going away. Once Amazon taught us that we needed it — and we never would have imagined it ten years ago — I don't think we could live without it. I think it's no different than Steve Jobs and the iPhone. Who would have thought? Or the iPod, even, who would have thought? I just don't see it going away. So when I see and talk to customers — in fact, we did a panel at one of the other investment day conference, and that panel of users and participants, they had a similar stronger view that this is not a land grab that's about to turn over on itself, but this is something that's still in the early innings and will be, I think, a positive influence on our business for a long time.

Bill Crow
That's great. Thanks for the color.

Operator
The next question is from Mitch Germain at JMP Securities.

Mitch Germain
Good morning, guys, or good afternoon. I'm just curious, Phil, going forward, your approach to dispositions. Are they going to be more opportunistic, given the fact that you pretty much have transformed the portfolio to a market mix that you're more comfortable with?

Phil Hawkins
I think, no, to me they'll be an important part of the way we fund our growth and driven as much by our view of economics as by the building function. The three Indianapolis buildings that Matt mentioned, there's a couple left in Cincinnati, probably a couple around the country where I would count them on one — on two hands, and maybe even one hand after Indianapolis is gone, where we're selling them because functionally we just don't think that they're consistent with what we want on the long term, but from here, it's a function of economics, using dispositions to self-fund, if you will, growth, and you'll see them, we got ahead of it — dispositions earlier in the year. We did tap the ATM a little bit in the third quarter, but dispositions will remain, I think, the most important source of capital for us to fund our growth, fund our development, fund our value creation and revenue enhancement activities.

Mitch Germain
Great. Thank you.

Operator
The next question is from Eric Frankel of Green Street Advisors.

Vince Taboni
Hi, this is Vince Taboni. We've heard that the obtaining of entitlements has been taking increasingly longer and also becoming very costly. Could you just discuss some of these entitlement trends in some of your markets, and do you think it's having any impact on constraining supply? And then it looks like as if your Arthur Avenue development, that some of the entitlement costs were pretty significant on that project.

Phil Hawkins
Sure. Neil, do you want to handle that?

Neil Doyle
Sure. If I just go to Arthur in itself, Vince, Arthur was a redevelopment where we took a building out of service, and in expanding the trailer park and the auto park and et cetera, we ran into stormwater management, known issues, known challenges. If you know where that building is at, and you know that business park, the old Centex Business Park, which is essentially Elk Grove Village, Illinois, you've got 100 million feet without any stormwater detention. It's a real challenge, so whoever wants to knock down or significantly rehab a building there, you are adding detention, and there's really nowhere to do it, and so it's expensive, and it's quite sophisticated in how it has to get done.

Phil Hawkins
So that's a known issue, but it's not going away, but the market certainly demands that it happens, and the market will pay you for it. Overall, when you go through entitlements — first of all, are you an infill company? And if you are, well, obviously there's no grass where you're building, you are replacing something else, sometimes something of significance. There's often lack of public infrastructure in the area, whether it be a stormwater detention or whether it be a third lane for truck maneuvering, so most municipalities are going to try to tag the developer with their "fair share" of offsite work. And that's very common in an infill environment. So time — it's sophisticated; money — because the municipalities generally don't have the money to do any work themselves, so when you ask for the right to add a development to their town, you are going to get hit with some costs. So we are seeing a little more time and a little more money, but that's where we want to be long term, and, you know, if it's worth building, it's worth the time to do it right.

Neil Doyle
And I would just add one more thing. I think it absolutely is one influence on why supply remains somewhat in check. Even in non-infill locations, entitlements are getting tougher, but where customers want to be, where the demand is, and where the money is to be made, takes longer and it costs more money.

Vince Taboni
Okay. Thank you. So, yes, it doesn't sound like you're going to have any meaningful changes, then, in that trend. One more quick one. Could you comment further on the Indianapolis disposition? Is that a market exit or just continuing pruning of the portfolio?

Phil Hawkins
Well, it's really two things. The three buildings we're selling are definitely buildings that we've identified as buildings that just don't fit with our long-term strategy, and I think it will fit better with the buyer's interests and objectives as well as probably capabilities. Indianapolis is not a market where we put people, and we've not invested money, and we'll be down to, I think, two buildings after this. We certainly like the market, but I don't think we bring any strength or unique attributes to that market that others aren't already doing as well or better than we can. So I don't consider it likely that we'll expand, and, quite possibly over time, we will exit.

Vince Taboni
Okay. Thank you.

Operator
This concludes our question-and-answer session. I would like to turn the conference back over to Mr. Hawkins for closing remarks.

CONCLUSION

Phil Hawkins
Hey, thanks, everyone, for joining the call today. We appreciate your interest in DCT and look forward to seeing many of you, hopefully at NAREIT, in a little over a week. Take care.
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Operator
The conference is now concluded. Thank you for attending today's presentation. You may now disconnect.