DCT Industrial Trust Inc.

Fourth Quarter and Full Year 2017 Earnings Conference Call

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CORPORATE PARTICIPANTS

Phil Hawkins - *President and Chief Executive Officer*

Matt Murphy - *Chief Financial Officer*

Melissa Sachs – *VP of Corporate Communications and Investor Relations*

Neil Doyle – *Managing Director, Central Region*

PRESENTATION

Operator
Good morning ladies and gentlemen and welcome to the DCT Industrial Trust Fourth Quarter and Full Year 2017 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 (0). After today's presentation, there will be an opportunity to ask questions. To ask a question you may press star (*) then one (1) on your telephone keypad. To withdraw your question please press star (*) then two (2). We do request that you ask one question and one followup; however, you may return to the question queue with additional questions. Please note that this event is being recorded.

At this time, I would like to turn the conference over to Melissa Sachs, Vice President of Investor Relations. Please go ahead.

Melissa Sachs
Thanks Denise. Hello everyone and thank you for joining DCT Industrial's fourth quarter and full year 2017 earnings call. Today's call will be led 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 2018 guidance. Additionally, Neil Doyle, Managing Director of DCT's Central Region, will be available to answer questions about the markets, developments, and other real estate activity.

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. Good morning everyone and thanks for joining our call. The fourth quarter capped off another excellent year for DCT. Rent and NOI growth were strong as market dynamics remained favorable for owners and developers of well-located, high-quality distribution assets. Leasing and our development pipeline is also progressing well. In the fourth quarter, we stabilized four assets with projected investment of $144 million at an 8.2% yield and an estimated value creation margin of 49%. With the stabilization of these four buildings and the start of two new projects in Atlanta and South Florida, the current pipeline is now 19% leased.

However, on a same-portfolio basis, last quarter's pipeline is now 40% leased. Leasing discussions are active on all projects in the lease-up phase and we expect a number of leases will be executed in the near future.

During the quarter, we took advantage of the strong investment sales market by selling ten assets for just under $130 million at a projected year-one yield of 6.3%. For tax reasons, four of these assets closed in January. These assets were 99.9% leased, consistent with our philosophy of selling stabilized assets to further maximize value. These sales completed our exit from both Memphis and Charlotte, and earlier in 2017, we exited Louisville, reflecting our strategic objective of focusing our capital in markets which we like long-term and where we have a strong presence in terms of both people and real estate.

Looking ahead, our outlook for 2018 is very similar to 2017. We expect customer demand will remain healthy, market rental rate growth will average in the mid-single digits, and while supply will continue to move up modestly in response to low vacancy rates, developer behavior will remain disciplined with respect to both starting new projects as well as leasing them. As a result, our strategy for operating our portfolio, deploying capital, and selling assets remains the same. While we are not projecting our occupancy levels to move up from here, we expect that significant growth in rents as well as rent bumps will continue driving same-store results. And in this environment, we remain focused on developing new assets, mostly on a speculative basis, as quickly as we're able to complete the land acquisition and entitlement process. We also expect that our market teams will continue to find at least a few quality acquisitions that provide attractive longer-term growth opportunities, and we will continue to be an active seller of stabilized assets where values have been realized and we have better uses for that capital.

With that, let me turn it over to Matt, who will provide more color on Q4 results and our initial guidance for 2018.

Matt Murphy
Thanks Phil and good morning everyone. 2017 was a remarkable year, both in our industry and specifically at DCT. Market occupancies continue to improve from what were already historic levels and the active demand for space has driven rental rates to new heights, particularly in prime locations in major metropolitan areas. Perhaps more importantly, users of industrial space are continuing to invest in their logistic networks and facilities, both in terms of their own capital investments and the rents they're able and willing to pay as they seek to generate efficiencies and competitive advantages in the rapidly evolving distribution world. DCT's ability to capitalize on these trends served us very well in 2017 and we believe many of these trends are just beginning to take shape, which bodes well for 2018 and beyond.

Our fourth quarter was a very solid conclusion to an exceptional year. Operating metrics, including occupancy, rent growth, NOI growth, and retention for the quarter were all consistent with our lofty expectations and our exceptional portfolio, rent roll, and development pipeline leave us very well-positioned to drive operating performance and earnings growth along with creating substantial value in 2018. We're initiating our 2018 funds from operations guidance of between $2.52 and $2.62 per fully diluted share.

From an operating perspective, we expect our metrics to remain very strong in 2018. Our guidance is based upon consolidated operating occupancy averaging between 96.7% and 97.7%. We expect re-leasing spreads in 2018 to be similar to or perhaps a little below those we achieved in 2017, although, as always, these numbers tend to vary from quarter to quarter. We expect these re-leasing spreads, despite the fact that only 8% of leases expiring in 2018 were signed during the recession compared to almost 40% in 2017. We continue to experience and project very positive trends in market rental rates and other lease terms, including free rent and rent bumps. All of these factors should combine to produce same-store NOI growth for 2018 of between 4% and 5% on a cash basis and between 2.8% and 3.8% on a straight-line basis. The growth in cash NOI will be driven by strong re-leasing spreads, a slight decline in free rent, and excellent rent bumps, which currently exceed an annualized 3% for those leases that have future rent bumps. Currently, 95% of our leases greater than one year included rent bumps and 88% of those have a future rent bump. At the midpoint of guidance, our average occupancy in our 2018 annual same-store portfolio is expected to be essentially flat as compared to the 97.5% average occupancy the portfolio experienced in 2017. The annual same-store portfolio represents all buildings stabilized as of January 1st, 2017. It should be noted that guidance for all operating metrics does not include the potential impact of any future acquisitions or dispositions.

Turning to capital deployment, our guidance contemplates development starts of between $175 [million] and $275 million. All the anticipated starts are on land that we currently own or control. We feel confident in the bottom end of the range and starts in the upper end of the range or beyond will depend on leasing in our existing projects, under development, and/or successfully securing final entitlements on several projects, a process that continues to get more challenging in today's environment. Our guidance also includes between $50 [million] and $150 million of acquisitions in 2018. While it's a very challenging acquisition market today, we are optimistic that our market teams will continue to find opportunities that simultaneously create value and upgrade our portfolio at attractive risk-adjusted returns.

With respect to our capital plan for 2018, our guidance is based on a funding plan which will maintain a debt-to-EBITDA ratio similar to what we achieved in 2017. Our sources of capital will likely be a mix of opportunistic equity issuance and dispositions, with a continued bias towards selling assets. Our guidance contemplates up to $100 million in equity issuance and dispositions between $200 [million] and $300 million, which includes the approximately $100 million which closed in January. We believe that the continuous improvement of our portfolio, both through addition and subtraction, is a critical element of our strategy to drive per-share value and long-term cash flow growth, even if it may come at the cost of modest short-term dilution in earnings. Finally, our capital plan contemplates a $300 million debt transaction towards the middle of the year, with proceeds targeted towards funding debt maturities we have in 2018 as well as paying down our revolver.

In summary, we are very proud of what we've accomplished in 2017 and over the last several years at DCT. We have created an organization that is incredibly focused on creating and maintaining a best-in-class portfolio and optimizing the operation of that portfolio, which has allowed us to generate exceptional financial reports and produce long-term value for our shareholders. We're also very fortunate to be in an industry that is directly benefiting from significant changes in the way American consumers are procuring goods today, positive changes that we and I think most people believe will continue for many years. And so we embark on 2018 with a sense of purpose and optimism, pleased with our past results and track record, but also very aware that our success is ultimately defined looking forward.

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

QUESTIONS AND ANSWERS

Operator
Thank you. Ladies and gentlemen, we will now begin the question-and-answer session. To ask a question, you may press star (*) then one (1) on your telephone keypad. If you are using a speakerphone, please pick up your handset before pressing the keys. To withdraw your question, please press star (*) then two (2). Once again, we do ask that you limit yourself to

one question and one followup, but reenter the queue for any additional questions.

Your first question will come from John Guinee of Stifel. Please go ahead.

Aaron Wolf
Hey all. This is Aaron Wolf, calling in for John Guinee. How is everyone doing?

Phil Hawkins
Good.

Aaron Wolf
Great. Quick question, how much did the $130 million or so in asset sales, what type of drag did that have on '18 FFO?

Matt Murphy
Yeah, this is Matt. It's a somewhat difficult question to answer specifically because you've got to make other assumption about what would have happened otherwise. According to my math, and it's really not just the ones that we closed in the fourth quarter, but the expectations for, or dispositions we have throughout the year, it's probably somewhere around between $0.03 and $0.04 a share on a leverage neutral basis, if you assume you're looking at it on a leverage neutral basis. So a little less than 2%.

Aaron Wolf
Okay, great. Thank you. And one more. I noticed,- we noticed, that G&A, as a percentage of NOI, came down pretty significantly. And just wondering if anything unusual there, if tax rebates or anything like that helped bring that number down?

Matt Murphy
No, I think the short answer is we've got NOI growing at a faster rate than G&A. G&A is inflation-ish, perhaps maybe a little bit more than inflation, and NOI's just growing faster.

Aaron Wolf
Okay, great. Thanks for taking my questions.

Operator
The next question will come from Manny Korchman of Citi. Please go ahead.

Manny Korchman
Hey, good morning everyone. Matt, in your occupancy guidance, do you have any large spaces or outsized spaces that are known move-outs?

Matt Murphy
Yeah, known move-outs, well, the short answer is we have basically six spaces of greater than 200,000 feet that are rolling. The three of those, including the largest, we feel pretty good about. Two, we know we're losing, although we have a 400,000 square foot space in Atlanta that we know we're going to get back this year. It's scheduled to expire in April. We think there's a potential for some short-term, but they are moving into a build-to-suit, so we know we're moving that one.

We have two others 200,000-ish known move-outs, one of which we're pretty sure we won't get any occupancy in in 2018. The other, we have pretty good, healthy negotiations going on to backfill that space the day it expires. Beyond that, there's probably 500,000, between 100,000 and 200,000 square feet spaces that we "know we're going to get back." Most of those tend to be a little bit more back-end weighted in terms of timing. But I also will tell you that what I would have thought were known move-outs at this point last year, we rescued probably three or four. So, a known move-out is not always certain. But I think we have a fairly low level of expirations remaining in 2018, and I would characterize this as pretty much par for the course.

Manny Korchman
Got it. Thank you. And then in terms of developments, have your lease-up assumptions changed at all, especially in terms of timing?

Phil Hawkins
No, we've underwritten in 12 months. We've been fortunate to be a little short of that, thankfully, in the past. I expect on average, we'll be pretty close to 12 months, maybe a little short as well. We'll have a couple of projects go longer, a few that go a lot shorter, and a bunch that take between 10 and 12 months to get -- it's not just leased, but occupied in my mind. And just getting, tenant build-outs are more sophisticated, it just takes a little longer to get a tenant through the process.

Matt Murphy
And to add to that, I'll tell you from a budgeting perspective, you asked underwriting, but budgeting, I am assuming for all new developments that there's 12 months downtime unless we know there's a lease coming.

Manny Korchman
Okay. Thanks guys.

Operator
The next question will come from Jamie Feldman of Bank of America Merrill Lynch. Please go ahead.

Jamie Feldman
Great. Thanks and good morning. Just going back to the known move-outs -- what's the total amount of space you think is moving out? And is that a meaningful drag on same-store? And then as we look ahead to ‘19, will there be a drag there or do you think it's not that meaningful?

Matt Murphy
Yeah, the way I look at it, the total amount of square footage that I think is going to move out is within a range, like it is, I just kind of went through the specific assumptions on a few of the spaces. I don't have a number in front of me and I'm not sure I would share a micro number anyway. What I would say is I don't think it is -- our retention numbers have been extremely strong for the last few years. I'll tell you that I'm probably budgeting lower retention that we've experienced in the last couple of years, but I don't think that there is anything that's unusual that would say 2018 is adversely affected nor do I think the result of that is going to be a problem for 2019. In fact, I think as I think about it, it's about re-leasing the space that does move out, and we continue to see such excellent prospect activity as soon as that space became available that I feel like the general trends that we've been seeing are likely to continue. The fact, the move-outs that I just talked about, as I said, are not anything atypical. I think the only thing that's probably a little bit unusual is that we are -- the roll happens later in the year than I would think of as normal and honestly, that probably has an adverse impact on 2018 same-store because the standard math that everyone says if 20% rolls and you get X percent of re-leasing spreads,

it translates into Y from a same-store growth perspective? The fact that you have a smaller amount of space that's happening a little later dampens a little bit of ‘18, but perhaps sets you up better for 2019. But these are all assumptions of uncertain future events.

Phil Hawkins
Excuse me, not to have too much budget discussion. But our budget retention in ‘18 is very similar to what we budgeted in ‘17. We may get some wins that we didn't count on in the budget. We may get a few losses, because you just don't know. But there's nothing in the ‘18 retention budget that is different than the ‘17 budget.

Jamie Feldman
Okay, that's helpful. And then maybe just some bigger-picture questions here, or question. Can you talk about your thoughts on tax reform - what it's going to mean for demand and any early thoughts on the NAFTA negotiations for warehouse?

Phil Hawkins
I think, to me, it's too early to tell how much of a benefit it will be. But I believe it will be a benefit. Maybe very modest, maybe a little more than modest as companies invest more into their businesses because of the benefits of tax reform, not just the lower corporate rate, but accelerated depreciation on equipment. They don't get accelerated depreciation in real estate. So, it doesn't set us up as it could've, if they did, by putting us in a competition with corporate buyers. So, I think overall, tax reform will be at least a modest positive. Haven't seen any change in the trajectory of demand. Demand has been so strong that I'm not sure we will notice it, anyway, but it may be one more factor that keeps demand healthy.

Jamie Feldman
Okay.

Phil Hawkins
I might also add -- I'm appreciative of the fact that real estate was treated well, REITs were treated well. The 1031 exchange, the dividend benefits, I think REITs, and hats off to NAREIT for communicating so well with the Hill. But thankfully, REITs were treated well, too, which could, was not a given a year ago.

Jamie Feldman
Okay. And then any early read on NAFTA or--

Phil Hawkins
Oh, okay – yeah, I believe in the benefits of global trade. And anything that impairs global trade, I believe, is a mistake for our country and for our economy. If NAFTA -- I think the question becomes, if it’s changed, what changes? If it's canceled, terminated, what happens? I just -- I hope that it will -- the results of that will be more modest over time, but we'll find out and I’m more hopeful or I hope that our politicians and the negotiators will have rational thoughts and reach conclusions and compromises that work for all three countries.

Jamie Feldman
Okay. So, too early for a read-through for like warehouse markets and demand based on what you’re seeing?

Phil Hawkins
Could it help maybe more stuff get on-shored manufactured from Mexico? Maybe. Does it hurt

trade between the two and therefore, have some impact on warehouse demand? Maybe. But if consumption remains consistent, and I think in the short run it likely would, regardless of NAFTA. If consumption is good, our customers will be focused on getting product into and out of their warehouses and that's good for us. It might have a very modest impact on one market, submarket versus another. But overall, I think consumption will march right on.

Jamie Feldman
Okay. All right. Thanks guys.

Operator
The next question will come from Craig Mailman of KeyBanc. Please go ahead.

Craig Mailman
Hi guys. Matt, you guys have had a pretty good track record over the couple years of setting initial same-store guidance at one level and coming in 100 basis points, 200 basis points ahead. I know you talked a little bit about some of the expiration headwinds and occupancy headwinds with some of the move-outs. But could you talk about what could cut your way that could be a tailwind here as we go throughout the year?

Matt Murphy
Well, I think there's probably three things that have the potential to. We touched on one of it. It's interesting. I read the notes last night, and we talked about conservative same-store guidance. In some ways, I get that because I'm predicting average occupancy that’s lower than where we sit today in a very hot market. So, you could look at that as being conservative. The other thing I look at is I've got same-store guidance that the bull's-eye is on 97.5% occupancy. That doesn't strike me as terribly conservative. Honestly, the budget is predicated on the move-ins of currently vacant space are a little back-end weighted. It's the natural psychology of budgeting. It's hard to predict somebody’s going to move in February if you're not trading paper with them today. Having said that, we've seen tenants make fast moves based on the limited availability of space. So, occupancy, that’s a long way to saying occupancy would certainly be a benefit. It's not a birthright that we're going to get 97.5%, either. So, that's why there are ranges.

The other thing that I think there’s probably much as much a historical precedent as any is rents. We've said this time and time again and I think you've heard others in our industry say it; we have underestimated the impact of the growth in rents. It's such a tight market. Some of these commodities or at least -- some of these locations are so important to these companies that they're willing to pay what they need to be in some instances to get it. And as a result, we've underestimated rents. I think, as based on what I was talking about in terms of when space rolls, it's probably got as much potential upside in ‘19 as it does in ‘18 because those higher rents, if we get them, are not going to be outstanding for that long a period of time.

But clearly, both my tummy and history would tell you that there is a potential upside with respect to rents. And the other one is probably less likely to be significant, but I’ve talked about it before and it's a reality is that miscellaneous income, which is, we talk about this theoretical same-store NOI growth and we're always talking about the mechanics of rent. Well, while rent is an enormous majority of what's going on in NOI, it’s not all of NOI, and so we're projecting miscellaneous income in ‘18 that is less than what we actually experienced in ‘17. It's a high six-figure number, low seven-figure number, not a huge one, and that's just -- that is a prediction of a totally random series of events. So, that has both potential upside and potential downside. So, as I've said before, what our same-store number is, is a bull's-eye of my budget. And clearly, there is less absolute upside on occupancy than we've had in the past when you're sitting at 98%, it doesn't go a hell a lot higher, but that's the way I think about it.

Craig Mailman
That's helpful. And then maybe, Phil, on dispositions, you guys obviously executed on the bigger sales early in the year. Just curious what you're seeing in that market from a demand perspective for single assets versus portfolios. Is that premium back with Blackstone back in the market being very active? And just how are you guys thinking about, as you look at the portfolio today, are there whole markets you'd rather get out? Is that easier today to do than it was 12 months ago? Or is it just going to continue to just be opportunistic pruning?

Phil Hawkins
Well, there's a lot there. But the answer is the market is strong, maybe stronger today than it was even a quarter ago in almost all markets in all sizes. The most significant change we've noticed over the last three or four months is there's more of a bid for lower quality assets, but the portfolio premium is there. The reason we decided to sell what we call the Southeast portfolio, which was one building in Orlando, one in Charlotte, and two in Memphis, was we believed in conversation with our broker that there would be a portfolio premium. And indeed, while it's hard to measure at the end because you don't know what you would have gotten if you would have broken it up. But we probably, we estimate that portfolio was 4%, 5% and which is what led us to that execution.

On the other hand, we don't have large portfolios left that are homogenous relative to the markets or product type. And so I don't think you'll see something like that in 2018. We have a couple of packages out now that are one or two buildings in size because that's what we want to do. It's the right execution for us, and we expect the pricing will be quite healthy. The demand is from all across, you know, the Southeast portfolio; it's public knowledge the Canadian REIT bought that. But we saw pension funds and private equity industrial focus funds compete actively for it. We had four very strong bidders at the end right on top of each other and we picked we felt was a very close call. But we had the luxury of having a choice, similar with the other sales we've done. We've had a pretty deep pool. And I'd say it's a deeper pool today than it would have been even six months ago. There's a lot of money out there.

Craig Mailman
Great. Thank you.

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

Eric Frankel
Thank you. I just want to talk about development guidance and your starts for the fourth quarter. It seems based on 3Q guidance that your development starts for the fourth quarter came in a little bit below expectations. You obviously filled that with a fairly large acquisition. But then 2018 starts, as you implied, probably are dependent on the type and process for a few different sites. So, that also came in a little bit light relative to robust demand on the tenant side. So, maybe you can expand on that a little bit more and see -- maybe characterize the probability of increasing your development guidance in '18?

Matt Murphy
Well, Eric, so I'll start. I'll certainly take the first part of that. Our guidance in 2017 -- the midpoint of our guidance was $325 million, we started at $326 [million], so, I think that was right

down the middle. I've gotten a couple of questions last night that is hard to figure out what the final tally is because we don't disclose development starts independently in the fourth quarter because you roll the guidance. But the absolute number was $326 [million] and the guidance was $325 [million]. And then I don't know, if you want to, Phil?

Phil Hawkins
I think that development, over the last several years I've probably made a similar comment at this time each year, we're not here to overpromise on development starts when there's a lot we don't control with respect to procurement of land entitlements and leasing, although hopefully we have some influence over leasing. I certainly like the opportunity in 2018 for development. But I believe it's much better to focus on assets that we love, that we control, and make sure that we lease what's already in the pipeline and not put ourselves in a position of overpromising on a faster lease-up than we otherwise underwrite in the prior project that may be in that same market. So, I think our guidance in '18 is very consistent with how we thought about guidance the last several years and from a volume perspective, it's probably not a lot different either. There is always room for upside.

This is also – there's also, honestly, as Matt just said and in his remarks, the downside is there's a lower end of the range we feel highly confident in. I feel good about the midpoint of the range and I feel okay about the higher part of the range, and I also think there's a chance to beat it. But I'm not holding out that as something people should be thinking about or counting on because we are thinking about quality of projects and results and performance more than we are quantity, but we do like quantity -- more quantity of high-quality projects is better and we're prepared to do more if we can get it.

Eric Frankel
Okay. Thanks for the clarification. Regarding the fourth quarter acquisition. I think that looks like a relatively new asset. Neil, since it's in Chicago I'm assuming you were involved with that transaction. Maybe you could talk about the circumstances of that type of deal and whether more of those are in the offing just given that development volume is increasing generally, maybe more of these opportunities will become available.

Neil Doyle
Sure, Eric. Yeah, you're right -- this is an acquisition from a private developer. Essentially, it's a brand-new Class A building. As always, we prefer to build everything ourselves, but we can't be everywhere at all times. So now and then, our strategy and goals complement that of a private developer. I think the mindset here was really to get a state-of-the-art, 36-foot clear asset in I-55, and you know the submarket, 2015 land pricing, 2016 construction pricing. And we take it to market for leasing in 2018. Things in 55 are pretty good. They have been pretty good. It's tough to get in there. So, when the opportunity presents itself, I mean, you're probably 85% is institutionally owned in I-55. So, opportunities don't show their faces every day. But when they do, we decided to jump.

When I look at the size of the building, and this, I think, was probably what you're looking for and probably the most attractive point that I can come up with when we first looked at this was there was one facility in I-55, which is roughly 100 million feet, the sub market, one facility over 700,000 feet available today, and that's ours. I do think this building probably divides itself. And if that's the case, there will be three competitors outright, two of those are Class A, and there'll be two buildings that can divide as a competitive set. But if we go back trailing maybe 2011 on, you're going to see about eight deals a year in the 400,000 to 500,000 square feet range. And so the math says you know what, we should be pretty comfortable with our lease-up period.

The math says that we should have a deal here. And really looking forward to having an asset of that quality right smack dab in the middle of 55. So, it was a late year deal, but we'll see how it turns out but we're pretty excited about it and especially as that submarket turns itself over. Going forward, a lot of your competition is going to be second generation. And that's 28 foot clear in I-55 and we'll be sitting at 36. So, a great deal, we hope. To date it is, and then we'll see if anything else appears on the horizon in a similar fashion in 2018. I hope that answers your question.

Eric Frankel
Not exactly, but I'll jump back in the queue. Thanks though, Neil.

Operator
The next question will come from Ki Bin Kim of SunTrust. Please go ahead.

Ki Bin Kim
Thanks. Good morning everyone. Just going back to your comments about lease spreads in ‘18 and ‘19, Matt. If you look at the mix and volume that is coming due next year, is there actually a chance that lease spreads accelerate?

Matt Murphy
Well, sure, there's a chance. As I've said many times, my least favorite thing to try and predict is re-leasing spreads because it takes into account such a wide range of potential outcomes. I do think we’ve spent a lot of time – I’ve spent a lot of time of talking about the impact of the really sort of the comparisons to the really what I think of as totally defensive leasing we were doing in 2010 and 2011. And that is, as I mentioned in my comments, there's only 8% of the remaining lease to roll that is compared against those. And I think that has an impact. Having said that, market rents have grown so rapidly in the last several years that it -- and I talked about this in previous quarters, that you've seen the post-recession leasing actually exceed the pre--- the during-the-recession leasing. So, I think it's got a potential. I think it's honestly unlikely to exceed it, but that doesn't mean it won't. I wouldn't have predicted what happened in 2017 a year ago. So, I feel like I have credibility issues. I think it's possible.

Ki Bin Kim
And I haven't checked your company map lately. But your Northern California exposure, you have about 40% expiring rolling over in 2019. Where is that exactly? And what do you think about the basis in that -- in those rents?

Matt Murphy
Well, that's pretty granular. I don't have detailed enough information in front of me to answer that, Ki Bin, sorry. I know -- as a general rule, Northern California is a pretty darn good place to be re-leasing space today. Yeah, we have 300,000 square feet, which is a little less than 8%. So, I don't think of that as a huge concentration. We have, obviously, the biggest leasing we have to do in Northern California is our development project. But I don't think of Northern California as having outsized, which is why I was struggling to come up with what the big…

Ki Bin Kim
I meant for 2019, where you have 1.9 million square feet expiring?

Matt Murphy
Oh, sorry. That, I'm definitely not prepared to talk about 2019.

Ki Bin Kim
All right. Thanks guys.

Operator
The next question will come from Blaine Heck of Wells Fargo. Please go ahead.

Blaine Heck
Thanks. Good morning. Phil, the development pipeline pre-lease rate is one of the lowest we've seen in a while. And it seems, I think, pretty similar to 2015, when you started with very low pre-leasing but you guys were able to lease a lot of that space up just in a couple of quarters. So, given what you're seeing as far as demand in the markets you're developing in, do you think that dynamic can be similar and you can see some big strides in leasing on the development pipeline in the coming quarters? Or is there any reason to think it might take a little bit longer at this point in the cycle?

Phil Hawkins
Well back then there was a little more of a -- we started much more at one time. This is a little more diffuse than that. So, therefore, the jump may be a little bit more modest. But what I said in my remarks was absolutely a fact. We've got a number of leasing prospects that our teams feeling pretty good about at each of our buildings that are now in lease-up and even most that are under construction. What I -- what we need to happen is for some or all of those to turn from proposals to being shifted back and forth and NOIs that are being negotiated to get to a lease. But it could happen where we have a, if that happens fairly quickly in one fell swoop. But I don't know if that's going to happen. I am confident that we will have a number of leases, five to five in the next month or two that happen. Could there be more than that? There's enough proposal activity that the answer is yes. But until it gets to a lease, I'm not prepared to even say that any of them will happen because -- but we're optimistic. We certainly expect that to go up before it goes down.

Blaine Heck
All right, that's helpful. And then maybe I can go back to Neil for the second question. Chicago's DCT second largest market for AVR. We've been hearing from some peers that there's an uptick in supply there recently. Can you just give us your thoughts on the market as a whole? And then how you feel about your positioning within the market?

Neil Doyle
Sure. The market as a whole, Blaine, 2017 was another great year of absorption and 2017 was an awful lot of supply as well. Most of that has been absorbed. And I think what's happened is there was a bit of a hesitation, call it middle of the year in 2017, on the absorption side. And if you look at the numbers, and you’ve probably got half the product under construction now as you did a year ago, what it has halted is the leapfrogging of spec development on the private developer side. So, I do think that it’s begun to temper itself naturally. And if the absorption keeps up the way current demand is said to be, is quoted to be, it will outstrip supply in 2018. And I think that's what we're all banking on. If I take a step back and look at the six or seven submarkets where we're focused, four of our seven submarkets are sub 4% vacancy. I mean, O'Hare is in the middle twos. So, we feel really good about the tight infill markets. I think -- and I've said this before, so I hate to repeat myself. But when you really look at Chicago supply and demand, you need to look at it with and without the I-80 submarket and I think it will give you a much clearer picture. I-80 always drives construction. It always drives absorption by default. But every building that's built down there is a needle mover at 1 million plus. So, if you take that out of the equation, I think you get a better sense. And Chicago is as tight as I've experienced,

and we'll see what happens in ‘18. But the "user activity" bodes very well for the supply at hand.

Blaine Heck
Got it. Very helpful. Thanks.

Operator
The next question will be from Nick Yulico of UBS. Please go ahead.

Nick Yulico
Thanks. Touching on a couple other markets where it sounds like supply may be picking up to meet demand, Atlanta, Dallas. What are your thoughts on how supply is impacting pricing and occupancy in those markets?

Phil Hawkins
It hasn’t been in the submarkets we're in. Neil's answer for Chicago applies to both Atlanta and Dallas. A lot – you’ve got to look at the commodity submarkets, which is in Atlanta it’s far North, and far South and then Dallas it’s far south. And where the big boxes are being built, and those boxes sometimes lease-up pretty quickly and sometimes don't. But if you look at the infill markets in those two -- infill submarkets in both those cities, they are very strong. And if you look at Atlanta, Atlanta supply and demand numbers, it’s very healthy. Dallas, it's -- the buildings we've been building have been leasing up as fast or faster relative to our pro forma than other buildings around the country. It's just a very strong demand market. We think you need to stay insulated inside closer to the city. That’s our strategy, frankly, almost everywhere. But it definitely applies to both Atlanta and Dallas and Chicago, where you've got commodity locations, where you can buy lots of flat, cheap land. But so far away that, frankly, many of the customers we try to cater to just aren't interested.

Nick Yulico
Okay, that's helpful. Just one other question. On the projected stabilized yields for the development pipeline that you quote, what are your assumptions there on how long it takes to lease-up to get to stabilized yield?

Matt Murphy
As I mentioned earlier, it's almost – this is Matt. It's almost always, in fact I can't think of an exception to it, in 12 months that you're assuming that it will occupy, as Phil mentioned, not leased, but occupied at 12 months out from completion.

Phil Hawkins
Unless there's a lease in place that obviously we update for re-leasing activity.

Nick Yulico
Okay. Thanks guys.

Operator
The next question will come from Michael Mueller of JP Morgan. Please go ahead.

Michael Mueller
Yeah, hey, just a quick one here. Matt, for the debt deal that you mentioned, can you give us an idea the duration you're thinking about and just any ballparks on pricing?

Matt Murphy

Yeah. So, yes, clearly, it's a little early to be getting into specifics, but I think the duration is easy. By far, by far, I'm thinking primarily in terms of the public market, and the public market is the far most liquid in the 10-year tenure. I think given where treasuries are likely to be, and I'm just going to simply give you a range because I don't exactly know where treasuries are going to be in the middle of the year. I'm thinking plus or minus 4%, probably between 4% and 4.25% for a 10-year deal.

Michael Mueller
Okay. That was it. Thank you.

Operator
The next question will come from Jeremy Metz of BMO Capital Markets. Please go ahead.

Jeremy Metz
Hey guys, good morning. Just in terms of your leasing activity, I was just wondering if you can comment on a broad level of which markets perhaps are underperforming your expectations right now. And then any new markets that are coming onto the watch list from a supply perspective?

Phil Hawkins
The answer -- the similar answer to both of those is none and none. And not to be short so I'll add little bit color. Across the board, the markets are doing well. Houston clearly has come back. Although we had a great year in ‘17 with Houston in terms of both leasing and rent spreads. So, we, thankfully, never took a pause there. Our development leasing, we built one of those spec buildings and we got a lease on that. I wouldn’t add a market to the “watch list”. And from a supply perspective, it's the same ones. We've mentioned, and it’s the commodity locations. It's Inland Empire East, Chicago I-80, it's Dallas and Atlanta that I talked about. Central Pennsylvania, you might add to that, into that list. It's where the big boxes get built. And frankly, we try to stay away from them.

Jeremy Metz
Okay, appreciate that. Just wanted to switch gears quickly on development. Matt, in your opening remarks, you had mentioned that you expect starts are all coming from the land you currently or have under option. So, beyond this, do you have enough land today that continue that same sort of starts cadence past 2018? Or will you need to replenish the land bank further? And sticking with that, what pressures are you using more broadly on land prices today?

Phil Hawkins
This is Phil, let me take a shot at that. The answer is we are clearly working on 2019 now. 2018, there may be a few pieces of land that we find we get going right away. But the most part, it's a long enough cycle that we need to work on land now to go into 2019. I think, as a company, I think about $150 [million] to $250 million of starts as being the right cadence, if you will, or volume. Some years, depending on markets and our entitlement process, that might be a little above that, and other times, it might be a little below that. But that $200 million is the sweet spot and $250 [million] on the higher end and $150 [million] on the lower end is how I think about it. And I would think at this point, that's how ‘19 will likely set up. God willing, if the markets continue to cooperate.

The land process hasn't changed. It's tough. Prices keep going up, so economics are challenging. But really -- beyond that, it's the entitlement process that is also tough. The good news is here it's tough for everybody else and hopefully, we're better as than most. And so it becomes, in many ways, a positive once you're successful. But I would say the land market hasn't changed and our strategy has not changed. We are not land banking. So, we don't own much land and won't own much land in ‘18 that we'll be starting in ‘19. And certainly, not until we get into late 2018 will we start even buying land that will be for 2019. There will be exceptions, but we're not land bankers. I don't think it's the right economic use of capital. Buy land that you're ready to go and you feel good about, get it going and lease it and not try to hold it over too many years because time is not your friend usually.

Jeremy Metz
Thanks guys.

Operator
The next question will be from Rich Anderson of Mizuho Securities. Please go ahead.

Rich Anderson
Thanks. Good morning. So, if I could just return to tax reform for a second. One of the other outtakes for corporate America is rents continue to be fully deductible whereas interest does not. It has at least the cap on it. I'm curious, when you think about the business of industrial real estate, it's been fortunate that Amazon has generally been a renter of distribution space while others like Walmart and Target have not. I'm wondering if there's any relevance to the shift -- maybe you're not seeing it yet, but do you think that there's a chance that you can actually see more business, not so much from the benefits of lower taxes at corporate America, but because of the fact that rents continue to be deductible for them.

Phil Hawkins
By the way, Walmart and Target are fairly active leasing -- leasers -- or lessees.

Rich Anderson
But they own some.

Phil Hawkins
They own some. But there's a lot of reasons that go into a company’s decision to own or lease. Certainly, their cost of capital and their availability of capital, the amount of money they're going to invest in space, the length of time they believe they need it and the predictably of their business. When there's a number of things that happen in the accounting rules that have, you thought would have driven more corporations to own than lease. And we got that question probably three or four years ago and those happened. We didn't see it. I think there's a lot more going on out there that is strategic and operational that drives those decisions. So tax reform may have a very incremental, modest impact, haven't seen it yet, obviously. But I don't believe it will be enough weight to shift the math, if you will, of each company decision. We've been buying buildings from companies and leasing them back. We've been buying buildings from companies and then letting them -- and taking them vacant. We've been selling to users and we're happy to sell to users. There’s no better buyer out there in this universe than that, and every one of the buildings we own is for sale at the right price. That’s the beauty about industrial. We're not in love with any one of our buildings. So, we'll react to the environment and more likely probably on the ground company-by-company or customer-by-customer discussions and we'll make the best decision possible based on the circumstances at the time.

Rich Anderson
Is the fact that you said the best buyer is the owner/occupier. Is that because they're not doing

the NOI math and cap rate and they're judging it differently and hence you can get better pricing that way?

Phil Hawkins
Exactly, exactly.

Rich Anderson
And then just a quick one for Matt. Do you have any lease termination incomes baked into your '18 outlook?

Matt Murphy
No. Well that's not 100% true. There's, I have a $200,000 in the first quarter that I'm pretty sure is going to happen. Beyond that, the answer is no.

Rich Anderson
Okay. Thanks guys.

Phil Hawkins
Thanks Rich.

Operator
The next question will be from Jon Petersen of Jefferies. Please go ahead.

Jon Petersen
Great. Thanks. Pretty much everything's been asked, but I just had one modeling question. Straight line rents and free rent were a lot lower in 2017 than they've been a long time. 2016 was like a really big year. As we think out towards 2018, how do you kind of expect those line items to trend and maybe bigger picture, I'm just curious how much free rent is factoring into negotiations?

Matt Murphy
So, I think the way to think about big pictures are frankly easier. What you saw in '16, there is definitely a high correlation to the initial lease-up of development properties and free rent. And free rent is in the part that always drives big swings and straight-line rents. Straight-line rent without free rent is extremely boring. It's a positive number in the first half of the lease; it's a negative number in the second half of the lease, assuming you have normally distributed bumps. So, as I think about -- we have a pretty healthy development pipeline right now that is likely to lease up over '18 and '19 that will drive free rent, which will push up straight line rent, the balance sheet element of the straight line rent. And so at the end of that day, I don't -- I think it will most closely follow whatever assumptions you're making about the lease-up of the development space. It's not that free rent only happens in development, but they tend to be longer leases. And as a result, free rent is almost always negotiated when it's present at all in terms of months free per year of term and development leasing tends to be longer. That's a long-winded non-answer, I apologize.

It's hard to predict. It's funny when you model stuff out, straight line rent in year four or five always turns to be a reduction of cash, but it never actually, by the time you get there, it never happens. I've never seen straight line rent being an overall debit in a company that I've been associated with. I've seen it in my forecast, I've seen it get close, but it never actually happens because you continue to add new leases on top of it that have bumps. And bumps are the other part that's driving it. When you initiate a rent, that number is always a positive, and it's a credit, if you will, to the income statement when you start.

Jon Petersen
Okay. Thank you.

Operator
The next question is a follow-up from Eric Frankel of Green Street Advisors. Please go ahead.

Eric Frankel
Thank you. Just to clarify, Neil, I do appreciate the very detailed response. You gave a good explanation on why you did that particular investment. My broader question though was regarding the opportunity to buy more merchant-developed assets over the next couple of years given that more of them have already been built. I think the way you described it that you're buying based off 2015 land pricing and 2016's construction pricing was interesting. So, I was wondering if you think more of those types of opportunities could come along.

Neil Doyle
Eric, my fault for misconstruing that. That is exactly an opportunity set. It's been there before. In fact, just in Chicago at DCT, we purchased an asset from the same guys three years ago, something they had bought as a value-add. They had stabilized. It was priced correctly. I do believe that the private developer world is certainly one of the many sources of opportunity for more the long-term hold-type companies. They're part of our business. You need to hang around. You need to keep in contact. And once in a while our goals will intersect, and I think we can complement each other. So, we'll see what happens. Go ahead, Phil.

Phil Hawkins
I'll just add real quick, Eric. What Neil said I'll underline once in a while. I don't think it's a big part of our business plan. The intersection of our ability to pay and their willingness to sell is more seldom than frequent. But where at happens and where we've got to the ability to take on that risk, we're happy to do it. We'd rather -- as Neil said in his first answer, we'd rather do it ourselves. But we can't do everything. And we're a developer as we find an opportunity and execute on it and it makes sense for us to take them out early, we'll consider it. It's not a, so.

Eric Frankel
Okay. Thanks. One more question for you, Neil. There obviously isn't a lot of lease roll-over in '18, but a lot of it is actually concentrated in Cincinnati. So, maybe you could talk about your leasing outlook there and the overall investment outlook in that market.

Neil Doyle
Oh, absolutely. Cincinnati is, without a doubt, one of the strongest markets we have in the Central Region today. This Amazon push, on top of just being a strong market, this Amazon push into the Northern Kentucky Airport has just been amazing for demand. And it really hasn't begun much in the way of operations yet. They are flying, but not to the extent they're going to be down the road. So, Cincinnati is extremely tight. Absorption has been extremely strong. I do think you'll see some reactive supply in '18 and '19, and we'll deal with that as it comes. But from our portfolio perspective, this is -- 2018 is a little on the heavier side for us in Cincinnati, but I'll put it in perspective for you. We had 29 leases in '17 in that market. We need to do 22 in 2018. We've got, let's call it 800,000 feet. A full half of that, 400,000 feet, is between two tenants where we are well down the road towards renewing. So, after that, we've got a lot of small units to go, not easy. But track record says it's just another year. So, pretty confident. That market's been very good to us the last three years running. And again, with this Amazon

boost, I expect Cincinnati to stay strong.

Phil Hawkins
And Eric, I'll add one comment there to put pressure on the local team. In addition to that, we're hopeful we'll have a development project in 2018 as well. So, that's how we feel about the market.

Eric Frankel
Okay. Is there anyone else on the queue? I don't want to take up too much more of your time.

Phil Hawkins
Go ahead.

Eric Frankel
It was related -- this is actually speaking of Amazon. So, I think there's a rumor, or maybe a confirmed rumor out there that they're experimenting with their supply chain, adding a new property type where it's an ultra-high, clear high building that has a small footprint in population-dense areas. Can you talk about their leasing activity or their expected leasing activity over '18 and over the next couple of years and how that's likely to evolve and whether you'd participate in building unique assets for them potentially down the road?

Phil Hawkins
I can't speak to the details of that. But I can tell you, it isn't our sweet spot. To build a specialty asset in an urban area is probably not something that we're likely to be involved with. As far as what we can tell they are planning activities, when they're paying us and others, they are pretty active right now for both build-to-suits, which is not again, that's not our sweet spot, we don't have a land bank. But in terms of both first generation specialty development as well as second-generation vacancy and the renewals with them all going -- it remains pretty robust.

Eric Frankel
Okay. Thanks. That's all I've got.

Phil Hawkins
Thank you, Eric.

Operator
Ladies and gentlemen, this will conclude our question-and-answer session. I'd like to hand the conference back over to Phil Hawkins for his closing remarks.

CONCLUSION

Phil Hawkins
Hey, thanks everyone for joining. We've got a good year in front of us, I hope. We're certainly focused on executing. We're going to have a number of investor conferences up over the next month and look forward to seeing many of you who are on the call there. And Matt and I are also available by phone if you want to talk further about any aspects of our business or company. Happy to do that any time. With that, take care and have a good weekend.

Operator
Thank you, sir. Ladies and gentlemen, the conference has now concluded. Thank you for attending today's presentation. At this time, you may disconnect your lines.