05-Aug-2011

DCT Industrial Trust, Inc. *(DCT)*

Q2 2011 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning, and welcome to the DCT Industrial Trust 2011 Second Quarter Earnings Conference and Webcast. All participants will be in listen-only mode. [Operator Instructions] After today's presentation, there will be an opportunity to ask questions. [Operator Instructions] Please note this event is being recorded.

I would now like to turn the conference over to Melissa Sachs, Vice President, Investor Relations. Ms. Sachs, please go ahead.

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

Thank you, Andrew. Hello, everyone, and thank you for joining DCT Industrial Trust's second quarter 2011 conference call.

Before I turn the call over to Phil Hawkins, our President and Chief Executive Officer, I would like to remind everyone that management's remarks on today's call will include forward-looking statements, within the meaning of federal securities laws. This includes, without limitation, statements regarding projections, plans, or future expectations. Actual results may differ materially from those described in the forward-looking statements, and will be affected by a variety of risks, including those set forth in our earnings release and in our Form 10-K filed with the SEC, as updated by our quarterly reports on Form 10-Q.

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

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

Philip L. Hawkins

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

Thank you, Melissa; and welcome, everyone. I will make a few comments regarding our strong operating results this quarter as well as our continued success in acquiring quality buildings and development opportunities, and then Stuart Brown, our CFO, will provide more details on the quarter and guidance for the year; Mike Ruen, our Managing Director of the East Region; and Matt Murphy, our Treasurer, are also participating on today's call and available to answer questions.

We had another strong quarter; leasing 4 million square feet, increasing occupancy in our total consolidated portfolio by 30 basis points over the last quarter, and acquiring $25 million of assets since April 1. Year to-date, we have acquired $72 million of assets with average occupancy of 81%, projected stabilized cash yields of 8.4%, year-one yields of 6.7% and an estimated discount replacement cost of 25%. Our acquisition pipeline under LOI or contract exceeds $100 million in a split approximately 70% stabilized and 30% value-add or under leased.

Further, we closed on two very attractive land sites in the quarter; one in the Inland Empire West submarket, and one in Miami's Airport West submarket. They are both located in very strong supply-constrained submarkets that have low vacancies and favorable rent growth expectations.

Our teams did an excellent job sourcing these off-market transactions from motivated sellers and what I consider to be very attractive bases. We expect to start construction on both projects by the end of the first quarter and are now well underway with entitlements and planning and et cetera on both projects. So we're moving rapidly.

We are working on several other possible land and development opportunities in costal markets as well. Our intent is to acquire infill land sites that will support one or two buildings in markets where we believe we can profitably develop new assets in the near-term.

A little over a year go, our California team advocated the purchase of a 19-acre site at 8th and Vineyard in Rancho Cucamonga, California at a distressed price of about $6.25 per land foot, well below pre-downturn pricing that was in excess of $20 per square foot. We have now fully entitled this site and the project is very active with serious negotiations with build-to-suit as well as the sale of a portion of the site to a user. We were very confident in this site and our cost basis when we acquired it, but frankly the speed of the market's recovery has been a pleasant surprise.

Turning to leasing, we had a strong quarter – stronger quarter than we've expected going into it, which has allowed us to increase as well as narrow our guidance for the year. We completed the lease-up of our first redevelopment project in Chino, California and have three other recently acquired value-add projects underway.

These value-add opportunities are located in the Airport West submarket of Miami, the Meadowlands, New Jersey submarket and the O'Hare submarket in Chicago. All three have very strong leasing activity and I expect them to lease-up sooner in a better economics than initially projected. By ticking on leasing risk and successfully executing on the projects, we will generate substantial value as well as recurring cash flow.

In terms of our outlook for leasing for the balance of the year, current lease proposal and negotiation activity remains encouraging. And our leasing teams our busy and upbeat. Activity levels are slightly below second quarter levels reflecting the typical summer slowdown, but well above last year at this time.

Our initial guidance for the year assumed a slower leasing environment in the first half and an accelerating pace in the second half of the year. We are now planning for some slowdown in activity in the second half, although we still expect net absorption to be positive. Hopefully, the recovery is stronger than we're projecting, but given recent political events and disappointing economic news, it is hard not to be a little more cautious on the recovery and plan conservatively. Stuart will provide more details on our revised guidance in a moment.

Lastly, I'll comment about sources of capital to fund our acquisitions and development activities. Our balance sheet is in excellent shape; EBITDA is growing; and our recent refinancing has provided us with plenty of flexibility. The strategy we previously articulated remains in place and that is to fund capital deployment with either equity or asset dispositions rather than increased debt.

In recent quarters, we have chosen to issue common shares through our ATM as well as an overnight offering. Given both the current level of our stock price and strong investment demand and pricing for assets, we have shifted our current bias for funding towards dispositions of assets and now have several packages of properties being marketed or under consideration for sale.

So far we are encouraged by the pricing feedback we are receiving and given the amount of capital-chasing industrial assets, I am very confident in our ability to successfully execute. I continue to feel great about the execution of our business plan, our markets teams are competing very successfully in leasing space, as well as in sourcing attractive capital deployment opportunities in our focus markets. Our organization and financial strength have positioned us well to grow and create value for stockholders and I look forward to reporting continued progress over the next few quarters.

With that, I'll turn the call over to Stuart, who'll provide more details and color on our results and guidance. Stuart?

Stuart B. Brown

Chief Financial Officer, DCT Industrial Trust, Inc.

Thank you, Phil. And we appreciate everyone joining us on today's call. To echo Phil's comments, we had a great quarter. Our market teams have obviously been very busy delivering stronger leasing activity and better occupancy than we expected due to the recent bumps in the economy.

As you've read in our release and as Phil mentioned, we raised our guidance for 2011 with the midpoint increasing $0.02 from our previous guidance, as a result of our strong financial performance and better than expected leasing in the first half of the year.

We signed 3 million square feet of leases in the second quarter, which is an increase from 2.5 million square feet signed a year ago. Base rental rates on comparable leases signed decreased in the quarter by 5.4% on a cash basis and 1.6% on a GAAP basis, which is an improvement from last quarter. The GAAP number is more significant as it reflects the rent bumps built into our leases following what may be low introductory cash rates. The average term on leases signed this quarter was 42 months with average turnover cost of $1.47 and a retention rate of 70%.

Total consolidated occupancy has increased 660 basis points from a year ago to reach 88.1% as of June 30. Additionally, we have 830,000 square feet or 1.4% of the portfolio leased and non-occupied as of June 30, representing $3.5 million of annualized base rent. Occupancy in the quarter is better than we had expected due to greater lease activity with new tenants taking occupancy earlier than anticipated.

Let me highlight couple of Midwest leases recently signed totaling 611,000 square feet. The first is a leading third-party logistics company and a subsidiary of a major Internet retailer, which fully leased our 221,000 square foot distribution building in the Riverport sub-market of Louisville, located near the UPS air freight hub. The lease was signed in May with the tenant taking full occupancy in June. This is one of a number of examples of pent-up demand for industrial space where teams have won deals by responding quickly with flexibility and creativity.

Second, just last week, we signed a 390,000 square foot lease at our Port Union development in Cincinnati. The tenant, a well-established sports apparel retailer, signed a 10-year lease as an expansion from their existing facility in California. The tenant will move in October 1, bringing occupancy in our 840,000 square foot Port Union project to 81% and occupancy in our Cincinnati portfolio to 87%.

At our SCLA and IDI joint ventures, we've also had great activity, some of which we discussed in our last call. SCLA is now 69% leased with the Fortune 500 food manufacturer Mars expected to take occupancy of 495,000 square feet in December. Additionally, we have a very strong prospect for the balance of the million square foot building.

In our joint venture with IDI, we have a contract to sell the vacant 509,000 square foot building in Stockton, California for almost $23 million, of which half the proceeds will come to DCT. The remaining three buildings in the IDI venture total 1.4 million square feet and are 45% leased.

Same-store net operating income in the second quarter decreased 1.2% on a GAAP basis and 1.4% on cash basis compared to last year. This reflects an increase in average occupancy of 250 basis points to 88.6% and the impact of rent roll downs as the average base rent per square foot in our same-store portfolio declined 3.4% from a year ago. Sequentially though, same-store cash NOI increased 2.8% in the second quarter from the first quarter on higher cash rental revenue with a 70 basis point increase in average occupancy.

Looking at some other lines on the income statement, general and administrative costs were $7.1 million in the second quarter, which is consistent with the first quarter, and up slightly from a year ago reflecting $500,000 higher expensed acquisition costs on higher acquisition volume.

Also, we recorded a causality gain of $1.2 million in the second quarter at a Tennessee property resulting from insurance proceeds exceeding the book value of damage caused by tornado. Further, we recorded a $1.9 million impairment loss, or about 10% of the total value related to the sale of the Stockton building in our IDI joint venture, which is expected to close in the third quarter.

With regards to capital markets activity, our recent accomplishments are reviewed in the press release and in line with discussions on our previous earnings calls. Consistent with our financing strategy, we have extended our average maturity to 5.6 years from 4.3 years as of June 30, 2010.

As a result of these transactions, as well as changes in market interest rates, our weighted average interest rate will be approximately 5.3%, compared to 5.2% a year ago. This includes using the proceeds from our recent unsecured private placement offering to pay down our line of credit and pay off our 2011 maturing mortgages. We didn't issue any shares during the quarter, but have raised $112 million to date from our February overnight equity offering to fund acquisitions.

The bottom line, we achieved funds from operations of $0.10 per diluted share in the second quarter and $0.19 per share year-to-date excluding impairment losses and acquisition cost.

Looking to expectations for the full year, we have raised and narrowed guidance. We now expect FFO per diluted share to range between $0.37 and $0.39, or $0.02 per share better than the midpoint of our previous guidance. This increase is mainly driven by the first half leasing activity, increasing occupancy and operating income earlier than we'd anticipated. Additionally, the casually gain added about $0.05.

Underlying guidance, total consolidated occupancy is expected to average between 87% and 89% for the year, with occupancy reaching near 90% at year-end. With a stronger first half 2011, GAAP basis same-store net operating income for the year is now expected to be flat to down about 1% compared to previous guidance ranging from flat to down 4%. Same-store net opening income in the second half of 2011 is expected to be flat to slightly positive.

With the acquisition activity Phil discussed, our guidance now assumes buying between $150 million and $200 million of stabilized and value-add properties for the year and selling around $50 million of properties in the fourth quarter. The $50 million of proceeds would be in addition to the $11 million raised from the sale of the Stockton building in the IDI venture.

The progress on our rebalancing of the portfolio, buying properties in coastal markets can be seen by our growth in Southern California, which has gone from our seventh largest market based on annual rents to our second largest market in just the past 12 months. The exciting pipeline of acquisitions, both core and value-add, as well as our select development disposition plans will continue that repositioning progress.

I'll now turn the call back over to Andrew to take your questions. Thank you very much.

QUESTION AND ANSWER SECTION

Operator: We will not begin the question-and-answer session [Operator instructions] The first question comes from Brendan Maiorana of Wells Fargo. Please go ahead.

Brendan Maiorana
Associate Analyst, Wells Fargo Advisors LLC

Q

Thanks, good morning. Stuart, I just wanted to follow-up in terms of the disposals, did I hear you correctly that it was $50 million in the fourth quarter, so I just want to confirm that. And then I think Phil you mentioned that you have a few packages out there. So I am just wondering in terms of the order of magnitude is $50 million sort of all that you are looking at, could you do more than that, would that number expect to go up again in 2012, and then maybe just a sort of range of cap rates that you think you can achieve on those disposal.

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

A

Sure. I can even answer the first question, because I was working with Stuart, it is $50 million, for the fourth quarter we have more than that in process, some of which could close in the fourth quarter, but more likely to close in the first quarter. And yes, we've got a fairly accurate program that we've sought through. And I expect that over time acquisitions and dispositions will roughly equal each other and obviously as long as the market remains healthy and what we expect.

Cap rates, low sevens to probably high sevens or low eights there are few user sales in there that would probably be lower than that. Maybe we sell an empty building or something where our cap rates not really meaningful, but generally stabilized properties in the market, so we are thinking about, I would say low sevens to high sevens and maybe a low eight or in there every once in a while.

Brendan Maiorana
Associate Analyst, Wells Fargo Advisors LLC

Q

So if we think about kind of acquisition roughly in terms of total proceeds equaling dispositions and you think about the value add – the mix of value-add and stabilized assets that you guys have been acquiring, do you think kind of when you look at bringing all the acquisitions to stabilized levels that initial cap rates stabilized are roughly in line with the disposition cap rates that you guys expect on sales?

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

A

I'd say stabilize might be close, but maybe a little bit touch below that. But also perhaps that might be thundering away that – we're not going to buy one building and sell a building, we'll sell a package and so we intended to be use the line a little bit and let the line get to $5,000 million, $7500 million and then bring it back down and I am not saying it's exactly how we're going to do it going forward, but the way we think about it, is given the volumes and relatively matched sourcing use of capital, it's very, very, very mildly dilutive, but statistically zero.

Brendan Maiorana
Associate Analyst, Wells Fargo Advisors LLC

Q

Sure. Okay. No, that's great. I appreciate the color. And then just on the couple of land deals -- $20 square foot FAR for Inland Empire West and then roughly around that number, I think maybe $19 FAR for Miami Airport, can you just kind of frame up what you guys are thinking about in terms of potential development on those sites, timing and then the returns that you think you can get and if it makes sense at today's rent?

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

A

Let me answer part of that and then turn it over to Mike Ruen who has sourced through his relationships the land site and Miami Airport West. Roughly a 650,000 square foot cross-dock facility in San Bernardino is underway. We are going through entitlements right now and zoning, going very well. So start – hope to start construction, frankly as soon as possible, sooner rather than later. We're right now projecting sometime in the first quarter. The fact is current rates work quite well, based on current rates and we think hopefully we will do better, we kind of – probably – low to mid sevens return and then with upside if we pre-lease it or lease it sooner and/or we get fortunate in terms of leasing economics both of which are possible, we've got honestly pretty good leasing activity already even though we just bought it.

That market, particularly San Bernardino, the Inland Empire in general, larger buildings are in short supply, cross-dock, it's very tough to build a large cross-dock building out there. We're very fortunate to have a site that allows us to do that and we are very proud of it. And so therefore we will go forward quickly, but also be pretty proud in terms of rent expectations. And hope to do better. Mike, do you want to add a little color on Miami West?

Michael J. Ruen
Managing Director-East Region, DCT Industrial Trust, Inc.

A

Sure. Miami West, a great location in the Airport West submarket. It'll be two shared rear-loaders, 28 clear light distribution, we'll kick-off that project – in fact we already have kicked off pre-development of the first 165,000 square foot building. We hope to get that permit in hand by December and kick that off for delivery in August of '12.

Brendan Maiorana Q
Associate Analyst, Wells Fargo Advisors LLC

So are there – when you look at land today, are there land sites – is there additional land sites where you guys think you can acquire and then put into motion in terms of development in a short timeframe similar to these deals or is there – or are these kind of one-off and you see that as unlikely going forward?

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

Mike, do you want to answer that or you want me to?

Michael J. Ruen A
Managing Director-East Region, DCT Industrial Trust, Inc.

Sure, I can take that. I would say it's selective in premier markets like Infield, Southern California or in Airport West, I think those are your outliers today and we believe that with the improving fundamentals we can create value very quickly as rent grows. I would say that these opportunities are very limited and so we feel very fortunate to have secured these sites. I think it's a little bit more time out there, Brendan, before you'll start to see this wholesale and other markets.

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

We have a couple other projects, we are working on, Brendan; it's a handful. One in – one where we – I think we will start construction fairly soon on a land that we already own in a joint venture and then also in another coastal market we've got a development opportunity we're working on and feel pretty optimistic about and we will start construction immediately there. But it's those kind of markets that we talk about for while now Southern California, Miami, Houston and there have already been in the construction projects started in Houston, some by our public peers that my guess will do quite well.

And so we would be – I think Houston would make sense and we've got – I'd say, we're working on one opportunity there, at least one, but one is pretty fairly mature that we hope we can close. And then, like I say, a few other sub markets – few other markets like Houston that we're trying, but it will be – it's going to be a handful of projects, maybe $100 million, $125 million of developed pipeline you kind of go into next year. That includes even the build this year we're doing on our 8th and Vineyard, that build-to-suit is likely to be a build-to-suit for sale. So it won't necessarily generate recurring income, but certainly will generate cash and value – and capture value which we can then redeploy into other opportunities.

Brendan Maiorana Q
Associate Analyst, Wells Fargo Advisors LLC

Yes. I guess...

Michael J. Ruen A
Managing Director-East Region, DCT Industrial Trust, Inc.

I'm sorry, but I'll just add little bit more color for you too, in any markets that we do have other activity on the development side in other focus markets, it'd probably be more fair to use a low to mid eights as expectations on yield.

Brendan Maiorana
Associate Analyst, Wells Fargo Advisors LLC

Q

I guess part of what I was driving at was, I mean, are you seeing that land pricing is starting to bubble up, does it make sense to develop at these yields given where cap rates are, are you seeing competition come in that would like to buy land at current values where they could good put into motion or is there just not enough buyers that want to take development risk yet and they can't lending to put that...?

Stuart B. Brown
Chief Financial Officer, DCT Industrial Trust, Inc.

A

Yes. Go ahead.

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

A

I would say, yes, absolutely yes. We have seen our competition coming in, but it's very challenging.

Brendan Maiorana
Associate Analyst, Wells Fargo Advisors LLC

Q

Okay. All right. Thank you.

Stuart B. Brown
Chief Financial Officer, DCT Industrial Trust, Inc.

A

Thanks, Brendan.

Operator: The next question comes from Steven Frankel of Green Street Advisors. Please go ahead.

Steven Frankel
Analyst, Green Street Advisors, Inc.

Q

Hi, good morning and thank you guys. Can you just talk a little bit about your markets? Some of your markets faired really well in the quarter, others didn't fair so well. Can you just shed some light on Miami, Phoenix, which I think was a pretty strong market for you as well as Charlotte?

Stuart B. Brown
Chief Financial Officer, DCT Industrial Trust, Inc.

A

Mike, this is Stuart. I'll start off a little bit and let you – yeah, turn it over to you to talk about Miami, couple of markets where we actually had decreases. One market was like Indianapolis. We had actually a frontier company move out of there about 100,000 square feet. Our team in Dallas actually already backfilled that space with a new tenant, the frontier company was actually expanding and we just couldn't accommodate their expansion, so the new tenant will be taken – moving in over the next three to four months.

And also in Indianapolis, we're talking about at the Handleman Building which has been vacant, that was a bankruptcy last year, we're working on a short-term lease prospect there that will bring in some income. Other markets where we had a little bit drop as well is in Nashville, we had a little bit of the drop, that's where we had a temporary tenant that I talked about last quarter that moved out that was CEVA, they've actually taken some additional space in Memphis, which is why our Memphis is up. Mike, you want to address Miami?

Michael J. Ruen
Managing Director-East Region, DCT Industrial Trust, Inc.

A

Sure, Stuart. In Miami, it's primarily the addition of our vacant 100,000 square foot building, our Class A acquisition. Actually, we will look at that as a positive Steve and then we've got great activity on it and we expect that number to move back up in the high 90s in short order.

With respect to Charlotte, the vacancy there really consists of just three spaces. One of which we just took back from a tenant that we just could not accommodate their expansion needs. The other two, one is a large bulk space and Charlotte unfortunately has been very slow on the bulk side here. And then the other is a more specialized building that has a higher level of office finish, little bit more narrow marketability on that asset, but again, making some progress, starting to see some more RFP traffic in Charlotte.

Steven Frankel
Analyst, Green Street Advisors, Inc.

Q

Okay. And then just a follow-up on the questions earlier about dispositions, Phil in the past you've emphasized a strategy of selling out of the Midwest I think primarily to redeploy on the coast, is that where the bulk of a dispositions are planned?

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

A

Yes.

Steven Frankel
Analyst, Green Street Advisors, Inc.

Q

Maybe more specific about markets or kinds of the assets that you're hoping that sell?

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

A

You know the one package that's on the street, so therefore, probably not all that hard to find out. We have a package of Minneapolis assets on the market. We've got a couple of the Midwest assets that we're thinking about in terms of user sales. And then we are looking at also another package that is not yet out, but will be out quite shortly in the next week or two in the central part of the country.

Steven Frankel
Analyst, Green Street Advisors, Inc.

Q

Okay. And you'd probably sell these more as portfolios than -- other than the user sales, forgetting that component for a second, you'd sell the rest of it more as a multi-market portfolio or something like that?

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

A

No, actually current thought is probably single market portfolios. We're obviously working with brokers and national teams of brokers and trying to get the best pricing, but what we've found so far is that sort of market-specific portfolios seem to be the best received, particularly in the central part of the country.

We did market a package in one of our joint ventures, and learned a fair amount about that. Also Midwest packages, Midwest markets, and you end up with buyers that frankly pick markets anyway. So for a variety of reasons; for example, Minneapolis is a stand-alone portfolio. Now, we may match that with the building in Kansas City or not. We may sell the building in Kansas City on its own, we may hold it, but – as an example. So we're remaining flexible, but at this point I think it's more likely to be market specific.

Steven Frankel
Analyst, Green Street Advisors, Inc. **Q**

And when you look long-term at what DCT might look like in a couple of years, are there markets here other than ones you just named that you might – the ones that you have a handful buildings in, should we expect you to be exiting all those markets or are some of those ones that you plan to retain a foothold in?

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

Yeah. Without naming names, I think there's two criteria that I think about when I think about dispositions and strategic – strategy. First is, we want to be in markets where we can have a major presence and that we can afford to dedicate the resources to have that presence.

So markets where we have – it may be good markets -- Minneapolis, as I've said before, people do quite well in that market. Kansas City, good market, it's just we can't be everything to everybody. And then second, overall, we would like to reduce our exposure to the Midwest or the central part of the country and increase our exposure in the coasts. So we may sell assets in some markets that we don't intend to exit. But we just believe that the assets themselves, it's appropriate timing and that strategically it's consistent with where we want to go.

Steven Frankel
Analyst, Green Street Advisors, Inc. **Q**

And can you just talk a little bit about...

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

[ph] But if I refer to the map, (29:38) I will – I do want to remove dots on the map.

Steven Frankel
Analyst, Green Street Advisors, Inc. **Q**

Okay. And so if I understand – there's a match-funding strategy, it sounds like there will be more dispositions into '12 than you have this year, first as acquisitions?

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

Yes. Obviously, we'll look at various funding sources, joint ventures, equity, dispositions. But right now, I think the appropriate source of fund remains, as far as I can see anyway, dispositions. We made good progress on our balance sheet in terms of leverage, which is helped most easily by selling of equity. I'm not saying we're done there, but we're very comfortable. And now, we'd like to, because of market considerations both on the equity – both on the common stock side but also on the private asset pricing side, I think it's time to focus on the portfolio and taking advantage of hopefully strong capital market pricing.

Steven Frankel
Analyst, Green Street Advisors, Inc.

Q

And just my final question, when you mention JVs, do you mean that you would form an acquisition joint venture? Or that you would sell stakes and assets to one of your existing funds or new partners, or how should we look at that?

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

A

We should, you know what, I don't mean to confuse people. The fact is, we do have access to that kind of capital, it is not in our plans at all, but certainly as capital markets change and they change by the moment, certainly by the day, we think about a number of different sourcing strategies.

Strategically, we're in the NOI business, not in the fee business and that's not to say others – other strategies aren't right, or that we can't supplement the NOI business with the fee business when appropriate. But at this point in time, what's appropriate for our company, I believe is wholly-owned, acquiring wholly-owned assets and then selling of assets.

Steven Frankel
Analyst, Green Street Advisors, Inc.

Q

Great. Thank you very much.

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

James Feldman
Research Analyst, Bank of America Merrill Lynch

Q

Great. Thank you very much. So, Phil, I was just hoping to go back to your commentary on the back half of the year where you said economic conditions are certainly warranting a little bit more caution. Can you just give us a more color on exactly what you are seeing by type of tenant sector and also by market?

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

A

Couple of comments, first, and probably more general than you want but maybe Michael can add some specifics. Proposal activity continues to be better than I would have expected, if all I did is read the newspapers and watch TV. The mood of our people – and believe me leasing people are mercurial, and they can move – like the capital market, they can move by the moment. And they remain upbeat, they're getting deals, they're getting proposals, they're making deals, it is down a little bit. I'd say trying to measure it, it's a little bit hard to measure honestly. But I'd say it is down a little bit from a couple of months ago. But it's July, early August now, but it's summer.

On the other hand, I worry and I worry a lot about what the mood of the country, what happened with the debt debacle. I worry about what is going on with GDP and everything, I mean, but yet industrial demand remains pretty busy. I'd say markets that are doing well and have done well remain active. California, the coasts, Houston, Dallas is active, Atlanta is active, Chicago, very active. Frankly, the last few weeks -- I think we signed a lease recently – actually, we had good leasing activity in our value-add building, I think we actually signed a lease in the last couple of days or we're about to sign a lease and so for another chunk of that building. Our West Chicago assets are doing very well. The markets that are – have not yet enjoyed any part of this recovery remain the Ohio markets for us. It's been – that's the area that I am probably most worried about and curious about what's going on.

Indie, a little slower lately than I'd like, on the other hand we've had good leasing activity over the last few months – the last six months or year. Memphis slowed down a little bit, but it is summer, is it timing, is it a fact – sort of our vacancy has been leased up. Who knows, Memphis has slowed down a little bit. Northern California has picked up in the last few months. I think I mentioned in the last call, so it's not necessarily a new news, but I think the tech recovery has driven that economy and we are busy, multiple tenants competing for spaces particularly near end, close end, stock end remains a little bit slow. That's why we've decided to sell the building that – with our IDI joint venture. Mike, do you want to add anything else to what I have said?

Michael J. Ruen
Managing Director-East Region, DCT Industrial Trust, Inc.

A

Yeah. I mean the only thing that I would add again is that our optimism is somewhat tampered by the uncertainty. And I absolutely agree that some of this is the summer doldrums and it's a bit of a wait-and-see on activity levels, but uncertainty is troubling. And then as we've said in previous quarters I think everyone is waiting patiently for the small and regional business to begin coming back. And that's certainly something that we need into filling your point that's the big part of our area in Cincinnati that needs help. So we like to see more activity from the small, but that's yet to come.

James Feldman
Research Analyst, Bank of America Merrill Lynch

Q

But have you seen any leases fall out of bed since over the last couple of weeks that you thought were done deals as a decision is just not that short term in nature?

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

A

Yeah, I'm not aware of any, Mike are you aware of any?

Michael J. Ruen
Managing Director-East Region, DCT Industrial Trust, Inc.

A

No I'm not aware of any.

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

A

The process of all of our leases I talk to just yesterday, day before and again she is busy and she also – I – not one single report of that.

Michael J. Ruen
Managing Director-East Region, DCT Industrial Trust, Inc.

A

If you looked in the rear view mirror, you would think the economy is fine, right, so when you read in the paper that you're worried about it. So no, we haven't lost to add anything really fallen a bed.

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

A

I worry about projects that may not happen, but projects aren't being cancelled.

Michael J. Ruen
Managing Director-East Region, DCT Industrial Trust, Inc.

A

Yeah, Jamie, I would add this again another very important component of our inbound activities obviously the third party transportation and warehouse providers. And they are very active pinging new accounts, but that's been slow to translate into leases. So I think there is some frustration on their front. But again, we haven't seen anyone just pull out of a transaction.

James Feldman
Research Analyst, Bank of America Merrill Lynch

Q

Okay. And then looking ahead to your expiration schedule, it was I think 7% left this year and then 20% next year. Can you just give us an update on how you feel about that pool of leases and where you think maybe rent spreads could be?

Stuart B. Brown
Chief Financial Officer, DCT Industrial Trust, Inc.

A

Hi, Jamie, this is Stuart. So I think if – we won't put up guidance probably until the next quarter's call. But if you look out, I mean our expiration schedule, where we sit today and what's expiring over the next 18 months is very consistent with where we've sat a year ago and two years ago. And if you look the leasing activity, there is nothing out there that really gives us a particular amount of worry in terms of the volume of leasing we have to do.

Rent roll down, as we sort of sit down and look at it, obviously, the leases that we're signing averaged four to five years, were signed still towards the peak of the market. So we expect leases to continue to roll down certainly through the first half of next year. Hard to sort of put an exact number on it at this point given probably there is sort of economic uncertainty. But this is probably I was guessing sort of mid to upper single digits probably still rolling down on average for the year and probably the second half of the year of 2012 getting a little bit easier, as you start to cycle in some of the short term leases that were signed at the worst part of the cycle. Expiration sort of by market, it's mostly whether expirations are remaining in '11 and '12 is a fairly good mix of our overall portfolio though.

James Feldman
Research Analyst, Bank of America Merrill Lynch

Q

Okay. And then Stuart, you had commented that same-store NOI is actually up sequentially. How much of that is seasonality and how much of that is kind of occupancy and cash bonds, I'm just trying to get a sense of the driver?

Stuart B. Brown
Chief Financial Officer, DCT Industrial Trust, Inc.

A

There really wouldn't be much seasonality in there, because our recovery rate is fairly flat. So it's really all occupancy and rent bumps. And as I mentioned on the call, I mean the rent bumps is really right now little bit accelerating. We've talked last couple of quarters about the amount of concessions we've given as things we stopped, but those concessions are starting to burn off, and you're starting to get better cash bumps going forward.

So if we look at sort of what's inherent in our portfolio, historically, you'll get cash rent bumps on average 2% to 2.5% a year in a lease, and 60% of your leases have bumps. If I look out into 2012, we're still at about 65% of our leases next year have bumps, but the average bump next year is actually closer to 5.7% on a space-by-space basis. That doesn't all take place January 1, but you really see the impact of some of those introductory leases, introductory rates that we've given as we've been leasing up the portfolio.

James Feldman
Research Analyst, Bank of America Merrill Lynch
Q

You're saying, do you mean free rent periods burning off get's you there?

Stuart B. Brown
Chief Financial Officer, DCT Industrial Trust, Inc.
A

Right, free rent periods as well as sometime getting leases instead of a free rent period, you maybe getting basically 50% of normalized rent for the first six months instead of free rents. So you start to get bigger bumps earlier in a lease.

James Feldman
Research Analyst, Bank of America Merrill Lynch
Q

So you think on a cash basis next year, 60% of your – is that 60% of our new leases or of your entire portfolio?

Stuart B. Brown
Chief Financial Officer, DCT Industrial Trust, Inc.
A

60% of our portfolio have bumps and the average bump in those leases is about 5.5%.

James Feldman
Research Analyst, Bank of America Merrill Lynch
Q

Okay. So your cash NOI isn't going to grow by that amount just after that?

Stuart B. Brown
Chief Financial Officer, DCT Industrial Trust, Inc.
A

Right, well, I guess, it doesn't all take effect January 1, it will take place during the year, but that's over a normal 2.5% bump.

James Feldman
Research Analyst, Bank of America Merrill Lynch
Q

Okay. All right. Thank you.

Stuart B. Brown
Chief Financial Officer, DCT Industrial Trust, Inc.
A

Thank you.

Operator: The next question comes from Ki Bin Kim of Macquarie. Please go ahead.

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

Thanks. Just a follow-up on that same line of question. You guys recorded a 2.8% increase in same cash, NOI quarter-over-quarter. Does that include – is that inclusive or exclusive of the casualty gain?

Stuart B. Brown
Chief Financial Officer, DCT Industrial Trust, Inc.
A

It's exclusive of the casualty gain, because that number is not in NOI.

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

Okay, just want to make sure. And just to give some perspective, could you give – if you had a number, the quarter sequential cash NOI increase from 1Q to 4Q, and 4Q to 3Q?

Stuart B. Brown
Chief Financial Officer, DCT Industrial Trust, Inc.
A

Let me – I'm not sure if I've got that right here with me – I'll call you back, follow back up on this specific question.

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

Okay. And going back to your comment about the 5.5% rent bump, so I mean – I guess the simple math is that next year cash, cash NOI should be up 3.3%, all of it – exclusive of occupancy change then mark-to-market, is there something – I'm missing in the equation that would reduce that number?

Stuart B. Brown
Chief Financial Officer, DCT Industrial Trust, Inc.
A

If you are assuming occupancies – our average occupancy is flat, no, it sort of cash basis that's about what we would do.

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

It would be half that, not two thirds of it.

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

Timing-wise, right, so timing-wise maybe that go down a little bit, because it's not January 1, right?

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

You've got to cut in half, right.

Stuart B. Brown
Chief Financial Officer, DCT Industrial Trust, Inc.
A

Assuming, it's an average medium of July 1, which I'm not sure it is, but probably pretty close.

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

Okay. So there isn't some other variable that goes into your NOI, it seems NOI equation that we might be missing, right?

Stuart B. Brown
Chief Financial Officer, DCT Industrial Trust, Inc.
A

So you are looking purely to rents. I mean, you had expenses in recoveries and a few other items that, so it's not – if you are only looking at cash based rents, your math wouldn't work.

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

Okay. And just ask that question in a slightly differently way. What is the amount of NOI that is not currently being captured that is related to free rent or teaser rates in your portfolio today and in a longer-term normalized basis where will that run rate go?

Stuart B. Brown
Chief Financial Officer, DCT Industrial Trust, Inc.
A

So we're not adjusting for teaser rates, but just in terms of spaces that are in free rent periods as of June 30, it's that $3.8 million and so teaser rates would add that a little bit. My guess is you are probably closer to on a normalized basis $2.5 million to $3 million in terms of any point in time.

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

Okay. So $1 million in additional NOI catch up?

Stuart B. Brown
Chief Financial Officer, DCT Industrial Trust, Inc.
A

Right, and that's down a lot from last quarter. The biggest mover was DHL lease in Miami, which occupied in early in the first quarter and they started paying cash rent in June, so yeah.

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

Because it was closer to $6 million, was that in the last quarter?

Stuart B. Brown
Chief Financial Officer, DCT Industrial Trust, Inc.
A

Higher than that, I think it was closer to $8 million or $9 million.

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

Okay. And this is not even including the – you said lease versus financial occupancies, I guess we'll call it at about a spread of 140 basis points, so what is the timing of that 140 basis points, and is that same-store?

Stuart B. Brown
Chief Financial Officer, DCT Industrial Trust, Inc.
A

Yeah, the majority that would be third quarter, some of that bleeding into the fourth quarter.

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

Q

Okay. And that same-store pool?

Stuart B. Brown
Chief Financial Officer, DCT Industrial Trust, Inc.

A

Not all.

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

Q

Okay. All right, that's it. Thank you guys.

Stuart B. Brown
Chief Financial Officer, DCT Industrial Trust, Inc.

A

Thank you.

Operator: The next question comes from Sheila McGrath of KBW. Please go ahead.

Sheila K. McGrath
Senior Vice President, Keefe, Bruyette & Woods, Inc.

Q

Yes, good morning. The occupancy pick up has been a positive trend, I was just wondering if you could give us some more visibility how you see that playing out over the next couple of quarters?

Stuart B. Brown
Chief Financial Officer, DCT Industrial Trust, Inc.

A

Sheila, this is Stuart. I think that will be as Phil mentioned in his remarks of these positive net absorption I think in our portfolio over the next couple of quarters and reaching again sort of 90%, near 90% occupancy at the end of the year, so a general -- slight pickup.

Sheila K. McGrath
Senior Vice President, Keefe, Bruyette & Woods, Inc.

Q

Okay. And also with the leasing activity that you've had for the past couple of quarters and going into third quarter, are there any trends in terms of new industries that you're seeing tenant demand from?

Stuart B. Brown
Chief Financial Officer, DCT Industrial Trust, Inc.

A

Mike, do you want to cover that?

Michael J. Ruen
Managing Director-East Region, DCT Industrial Trust, Inc.

A

Sure, sure. Sheila, we take a look at quarterly our new and expansions and – new deals and expansions and it's actually been fairly typical and constant. To give you a quick sampling, if you look at the new and expansion deals that we completed in the quarter, it's pretty typical, about 30% in wholesale trade. You've got some automotive parts, primarily OEM guys, some furniture wholesalers, commercial building suppliers, some industrial machinery -- very typical. After that you break down to about 20% manufacturing, some corrugated I had a pharmaceutical deal, steel fabrication, about 16% was in transportation, dominated primarily by our third-party providers. 13% of the deals were in retail, had food grade, sporting goods and one electronics group. And then no other category below 5%, so I'd say it's very typical, not many outliers.

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

A

The only thing I would add, Sheila, is we're seeing more inquiries and a few more deals from Internet fulfillment and they may fall-in by the base of the company into other SIC codes, but the fact is Internet fulfillment has been a pretty active area of inquiry around the country.

Michael J. Ruen
Managing Director-East Region, DCT Industrial Trust, Inc.

A

Yeah, agreed.

Sheila K. McGrath
Senior Vice President, Keefe, Bruyette & Woods, Inc.

Q

Okay. And last question, Phil, we've been reading in industry newsletters and stuff about a lot more industrial portfolios being shopped in the market today. Some with success, some being pulled and I was just wondering if you could give us your insights and interest level in any of the portfolios?

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

A

Well. I would say the market remains fairly bifurcated, meaning that the vast majority of the capital is still interest in stabilized assets, and reasonable quality assets. The capital has moved off the coast a long time ago into primary non-coastal markets and now good interest in second – decent secondary non-costal markets.

But as soon as you fall off from – in terms of stability – stabilization, your buyer pool falls off, which is, as a seller, what we're looking at is selling stabilized assets in markets where we we're confident there will be a fairly deep buyer pool. And then – so that – and then as a buyer we still remain focused on primary markets even costal markets. We're willing to take on leasing risk in modest amounts, because we are confident in our ability to execute and there is competition, believe me. But it's not the same feeding frenzy that exists with stabilized assets.

Sheila K. McGrath
Senior Vice President, Keefe, Bruyette & Woods, Inc.

Q

Is there a wide spread that you can point to in terms of acquiring individual assets versus the portfolios?

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

A

I'd say, yes, I wouldn't say a wide spread anymore. In fact, as capital spread out almost everywhere in terms of markets, size, so I'd say there's still a portfolio premium, but I wouldn't describe it as huge, I would just describe it as, it's noticeable as long as the assets are reasonably consistent, reasonably stabilized, and the market concentrations make sense or it's a huge national portfolio that also is pretty well thought of.

When you see national portfolios that have come out or good chunks of many markets, a number of them have not fully executed because of quality and/or leasing and seller pricing expectations. We've seen portfolios sell –

earlier, I guess it was last year, but when Blackstone was buying some stuff, there was certainly buying and they were buying assets that were actually in that case fairly stabilized, but in some second tier markets. There weren't a lot of buyers behind them and the price that they paid for them reflected the difference, the fact that they paid – they get a higher cap rate than they would if it were primary markets or newer assets. The fact is that that's still probably the case. But there aren't many sellers out there willing to sell at the prices required to clear to buyers.

Sheila K. McGrath
Senior Vice President, Keefe, Bruyette & Woods, Inc.
Q

Okay. Thank you.

Operator: The next question comes from Mitch Germain of JMP Securities. Please go ahead.

Mitch B. Germain
Director & Senior Analyst, JMP Securities LLC
Q

Good afternoon, guys.

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

Hi, Mitch.

Mitch B. Germain
Director & Senior Analyst, JMP Securities LLC
Q

You talked about development picking up in many of your markets, many of those markets of which you are targeting new developments. So Phil, just curious about how you are going to manage developing those markets, what's different in your approach today than call it two, three years ago when you kind of got stuck with a lot of activity out there and not enough leasing?

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

First, I would say, it's not many markets and it's not a huge pick up but it is modest and it's a few markets that are – that I think makes sense for us. And what we're doing differently, we several years ago began building our construction and development capability and then accelerated it further with bringing on Jeff Phelan and his team. We've made some additional hires in our markets that come from – people who come from development background and are developers. So we've built up an infrastructure and as a result our focus is on wholly-owned development as opposed to joint ventures where we are a financial partner in markets where we believe are strong – strong markets currently with strong barriers to entry and strong linked growth prospects.

When I look back, I'd say that gives us high margin are not doing as much as others did, but I also then say, we're developing – well, we did more than we should have and we're doing it in markets where we were relying on gross leasing activity, the Midwest, et cetera, that we'd say do it and lease it up, but then there is plenty other competition. And when you don't control the project that adds a few layers of complexity and also made it easier to shut it down too, we didn't have a big staff. So in many ways – and no big land inventories, so we were fortunate to not have a land inventory nor a bloated staff to have dealt with over the last couple of years.

But on other hand, the lack of control or lack of complete control or something I am not comfortable with, and something that we laid out a number of years ago as part of our strategic plan, that is what we're sticking to. So selective development, I would describe it as fairly low risk development, there is no such thing as low risk development, but lower risk development in markets that we have people on the ground and markets that we are confident in the market fundamentals, and then controlling those efforts.

Mitch B. Germain
Director & Senior Analyst, JMP Securities LLC Q

Thanks, guys. Great quarter.

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

And by the way, no large – you're not going to see multiphase, multiyear, 100 acre land sites, I got to pay up a little bit for land and not take land on their balance sheet that is non-productive and you may get it right, but you're going to get it wrong as often as you get it right in terms of timing. I'd rather pay retail for the land, one or two phase deals and put into production real quick that will also minimize I think financial and development risk.

Mitch B. Germain
Director & Senior Analyst, JMP Securities LLC Q

Thank you.

Operator: [Operator Instructions] The next question comes from Steve Benyik of Jefferies. Please go ahead.

Steven Benyik
Vice President, Jefferies & Co., Inc. Q

Thanks very much and good morning, guys. I guess, first, just looking at the negative 5.4% cash leasing spread in the second quarter, comparing that to the negative 15.5% in the first quarter. I was hoping you could comment a little bit about how much of that was just due to mix in space versus rent growth and how we can think about – how that might flow through the back half results given your negative 10% guidance for the year?

Stuart B. Brown
Chief Financial Officer, DCT Industrial Trust, Inc. A

Steve, this is Stuart. Thanks for being on the call. We've talked about in the past that we get a little bit of volatility quarter-to-quarter, just the mix of what leases are getting signed, mix of new and renewal, mix of markets, so I would tell you while I feel great about the second quarter numbers, the first quarter numbers and the bigger roll downs there didn't really – weren't something that really concerned me. So, if you look it year-to-date, rolling four quarters GAAP basis, you are down 5% to 6% on a GAAP basis, cash basis you are down sort of 9% to 10%. I think our guidance we put out for the year of down around 10% is still about right. So you'll get a little bit on a...

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

On a cash basis.

Stuart B. Brown
Chief Financial Officer, DCT Industrial Trust, Inc. A

On a cash basis.

Steven Benyik
Vice President, Jefferies & Co., Inc.
Q

Okay. And then one of your industrial peers mentioned that they might be able to see cash leasing spreads turn positive annually 2010, just wondering if you could provide us with an updated view on what you are seeing in your markets and when you think you might see that across your portfolio?

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

I think, directionally if you look at sort of national statistics and PPR, I think PPR still has rents rolling down through most of next year, but our specific portfolio, we'll talk about that with guidance.

Steven Benyik
Vice President, Jefferies & Co., Inc.
Q

Okay. And then on the development side, I mean it seems like its growing in focus a bit. I was hoping you guys could just perhaps ballpark what you expect development spending might be over the course of the next 12 to 18 months? And then also just looking at the cap interest number for the quarter, the $912,000 and tying that to the balance sheet where you guys had about $37 million of assets under redevelopment or land, I was just hoping if you could sort of tie that out, it looks like that would imply your capitalizing on about $73 million, just how we can sort of help the forecast that going forward?

Stuart B. Brown
Chief Financial Officer, DCT Industrial Trust, Inc.
A

Well, in terms of development in our pipeline, I would say – I think I mentioned even in my remarks or other question, I think $100 million to $150 million kind of by the time you get to the middle of next year. I don't see it being much higher than that and also I wouldn't be shocked it's even a bit little lower than that, but $100 million to $150 million.

Steven Benyik
Vice President, Jefferies & Co., Inc.
Q

Of actual spend?

Stuart B. Brown
Chief Financial Officer, DCT Industrial Trust, Inc.
A

Of...

Steven Benyik
Vice President, Jefferies & Co., Inc.
Q

Of starts?

Stuart B. Brown
Chief Financial Officer, DCT Industrial Trust, Inc.
A

Value of project underway, the actual spend I guess I haven't thought about that way, that albeit lag a little – be a little bit below that, because you're setting all your projects in the first quarter and you may get many of those done, but the other ones won't get them behind them, so I don't know, the actual spend maybe a little bit below that. I think the pipeline of some of those commitment, which in our business is a 12-month, its essentially 12 months anyway, by the time you get it done and maybe a little bit longer than that, but I think in leasing commissions and TI spent.

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

A

And I think your second question was more of sort of a general one, capitalized interest, so we are not capitalizing on too many projects today, we're capitalizing on 8th & Vineyard land, we'll be capitalizing on the Miami land and the land at San Bernardino as well. Other than that, there is a little bit of a capitalization going on in the couple of redevelopment projects, which right now is really the Chicago building, Miami and Chino are essentially leased today, but so there is a very little capitalization going on.

Steven Benyik
Vice President, Jefferies & Co., Inc.

Q

Okay. Thanks so much, guys.

Operator: The next question comes from Steven Frankel of Green Street Advisors. Please go ahead.

Steven Frankel
Analyst, Green Street Advisors, Inc.

Q

I just had a quick follow-up on the development starts and just if you guys could just discuss your return hurdles on speculative versus build-to-suits, if you were to have break ground on the Inland Empire, what's the required gap and yield that you would need to do a build-to-suit versus a spec starting San Bernardino?

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

A

Well, we are going to break ground spec, but hopefully, it maybe pre-leased before then, it may turn into a build-to-suit or a pre-lease and we've got some of the indication that that's possible right now. Although, I wouldn't say probable, certainly not at this stage is too early to say that.

And as I said, low to mid-sevens with upside to kind of high sevens if we pre-lease it. Obviously, in this case, the returns in a pre-lease are those that will be higher only because your down time is shorter. But we're looking for a couple hundred basis points spread over what we think stabilized value is, as well as meeting our own internal absolute hurdles from an IRR perspective and both Miami and San Bernardino easily meet both those criteria, relative value creation as well as absolute cost of capital comparison.

Steven Frankel
Analyst, Green Street Advisors, Inc.

Q

What do you think the un-levered IRR is, I guess low to mid sevens, it sounds like for this?

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

A

That's a stabilized return is, and that's not the IRR, and we don't – I'd rather not disclose IRR. One is there is obviously some mark to the IRR as well as science and we can – you got to get into the details of the calculations, but I would say we're comfortable with IRR as north of expected cash yield, you got rent bumps, just the rent bumps alone will be – will generate something. And then obviously you've got residual value that we also believe will be well north of our cost. So I'd say we're comfortable with the IRR as north of or in excess of our year one expected cash returns.

Steven Frankel
Analyst, Green Street Advisors, Inc.

Q

Okay. And then for other markets, those are the only two markets I think you mentioned where you believe that that's the case at present?

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

A

What's the case at present? I'm sorry.

Steven Frankel
Analyst, Green Street Advisors, Inc.

Q

To cover your cost of capital by starting selling?

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

A

I think we're looking at deal, I mentioned Houston, we're looking at deal on the East Coast, I don't know if we'd be successful in either one. I think our return expectations are a little higher in those. And I think that those are – there are a few deals were working on that can meet those return criteria. As Mike mentioned, some markets can be low to mid eight. Miami Airport West and Inland Empire West are the two kind of tightest, hardest markets with – in terms of leasing demand, but also in terms of investor demand. So are able to, in our view, take a – maybe a lower cash return for those reasons than you might be willing to take in some other markets. But in any case, we're looking at markets and it's not a lot of markets. I want to reemphasize that point where we feel we can buy land at a price that allows development to be started in the near future not necessarily land banking and hoping for rents to grow in the next couple of years to make the land price work.

Stuart B. Brown
Chief Financial Officer, DCT Industrial Trust, Inc.

A

One thing I'd add is again, even though obviously it is financially driven, as we look at the market like Miami or San Bernardino, the ability to acquire A quality assets in A locations is difficult, there is not that much for sale. So this is a way for us to continue to improve the portfolio and the market positioning by building high quality assets in those markets.

Steven Frankel
Analyst, Green Street Advisors, Inc.

Q

Great. Thank you.

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

A

By the way, not even answered your question, but I answered my own. We intend to hold these assets. We are not a merchant builder. We're not trying to generate merchant gains. We're trying to generate recurring, growing cash flow, which we will do, now I mentioned at 8th and Vineyard we'll do a build-to-suit to sell, we're happy to make money but our preference, our strategy is to build quality buildings that we want to own over time and will generate attractive recurrent and future returns.

Operator: This concludes our question-and-answer session. I would like to turn the conference back over to Phil Hawkins, CEO, for any closing remarks.

Philip L. Hawkins

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

Well, I think I just gave some. So I appreciate everybody's time. Look forward to talking with each of you, many of you in the coming days, weeks and months, and hope everybody has a great summer vacation. I hope you've got that planned after the last of the few earnings calls remaining. Thanks.

Operator: The conference has now concluded. Thank you for attending today's presentation. You may now disconnect.