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DCT Industrial Trust, Inc. *(DCT)*

Q3 2012 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning, and welcome to the DCT Industrial Third Quarter 2012 Earnings Conference Call. 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 Briana Ochiltree. Please go ahead.

Briana Ochiltree

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

Before I turn the call over to Phil, I would like to remind everyone that management's remarks on today's call will include forward-looking statements within the meaning of Federal Securities Laws. This includes without limitation, statements regarding projections, plans or future expectations.

Actual results may differ materially from those described in the forward-looking statements and will be affected by a variety of risks, including those set forth in our earnings release and in our Form 10-K filed with the SEC, as updated on the quarterly reports on our 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 on 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

Good morning and thanks for joining our call, especially those of you in New York, New Jersey and Connecticut no doubt had to overcome considerable challenges to join us today.

Our thoughts are with everyone on the East Coast and the tragic loss of life and property caused by Super storm Sandy. The storm's physical and emotional impact will be felt for quite some time. In terms of the impact on DCT, thankfully our employees and their families are all safe.

Also, it does not appear that our properties or our customer's operations sustained material damage or disruption. However, the building containing our New Jersey office, which we do not own was substantially damaged. All of our systems remained fully functional. Our team is currently working remotely and we're in the process of relocating them to alternative office space as quickly as possible.

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Our New Jersey and Baltimore teams have done a great job under very trying circumstances dealing with the storm's aftermath, communicating with our customers and meeting their needs as best as humanly possible. I'm very grateful for their efforts.

With respect to DCT and our third quarter results, we had a strong performance across all fronts as our market teams continued to successfully execute with respect to leasing, acquisitions, development and asset dispositions. While we indicated a slowdown in leasing on our August 3rd call, we saw a pick back up again in late August and into September, which certainly contributed to our favorable third quarter results.

Operating highlights from the third quarter include occupancy our consolidated operating portfolio increased 150 basis points over last quarter to 91.8%. This was driven entirely by leasing with no material impact from third quarter acquisitions or dispositions.

Same-store NOI increased 4.3% on a cash basis and 2.7% on a GAAP basis driven by both higher occupancy and higher effective rents. Rental rates increased 3.8% on a GAAP basis and 0.9% on a cash basis, the first time both of these metrics have been positive in quite some time.

Our improved rental rate metrics as well as lower free rent concessions are reflective of our market where leasing fundamentals are continuing to improve. As a result of the strong quarter, we moved the bottom end of FFO guidance, up $0.01 to $0.40, which moves the midpoint up from $0.405 $0.41 per share.

Let me offer a few more comments on the current leasing environment, as I know that's on the top of every investor's mind. Leasing activity is good and our market teams were better about what they're seeing today compared to 45 days ago. In October, we signed just under 1.2 million square feet of leases, which is a decent month for us and a good start to the fourth quarter. This includes 740,000 square feet of renewals, 200,000 square feet of new and expansion leases in existing buildings, and then the 225,000 square foot building expansion in Nashville.

Demand continues to be led by larger corporate users and 3PL requirements, although smaller size customer activity has increased in recent weeks as well. Increased activity from the housing industry, which tends to be more biased towards smaller users should also be a positive catalyst for industrial demand over the next several quarters, and we started to see some evidence of this in our third quarter of leasing.

Moving on to capital deployment, we continue to make excellent progress in sourcing attractive acquisitions in our focused markets. Since the end of the second quarter, we acquired eight buildings, located in Southern California, Seattle and Chicago, for a total of $41 million, representing a mix of stabilized and value-add assets, the average occupancy of these acquisitions was 79% with an expected year one cash yield of 5.4% and a stabilized yield of 6.3% with significant growth in subsequent years expected from annual rent bumps, as well as rents rolling up to market on several of the buildings. In addition as we announced in early September, we are currently under contract to purchase three air freight assets in Los Angeles and one in Chicago for a total price of $86 million. This acquisition is expected to close in November and will generate an initial year one cash yield of 6.5%. Our current pipeline of acquisition opportunities is active and I'm confident that we will be able to continue to find profitable deployment opportunities that generate attractive returns and future growth over time.

We continue to make great progress on the development front as well. Since June 30th, we acquired two outstanding land sites. The first is a 28-acre parcel in the Inland Empire West submarket adjacent to our Slover 1 building. Slover 1 is a fully pre-lease – its fully pre-leased and we are expected to break ground on it this month. The new site which we creatively named Slover II will accommodate 600,000 square-foot across dock distribution building. We hope to start construction of Slover II sometime next year once entitlements are finalized.

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The second site, a 46-acre parcel in the Sumner submarket of Seattle just closed last week. Currently, we're going through the entitlement process and plan to build two cross-dock distribution buildings, one totaling 614,000 square feet and the other totaling 4,000 square feet. Our team have been working on the site for a long time and it represents one of the very best development opportunities in the strong Kent Valley market. Grading and fill work has already begun and we hope to start construction on the first building later in 2013.

Lastly with respect to development, we reached an agreement with existing customer to expand a building in Nashville by 225,000 square feet as well as enter into a new lease for the project. Our development projects recently completed or under construction are 40% leased with strong activity on each of our available buildings, including several leases that are out for active negotiation. I'm very pleased with the performance of the program as it is a testament to each project's quality and location as well as our market team's efforts.

Moving on to dispositions, in Houston we sold 13 older assets totaling 1 million square feet to an investor and then two individual assets located in Northern New Jersey and Dallas to users. In addition, we sold a joint venture asset located in the Northern Kentucky submarket at Cincinnati to the current tenant.

The sales were at an average year one cash yield of 5.5% and generated proceeds of $61 million. We're currently in a marketing process with several other assets in the Midwest markets. The process is going well and we're optimistic that we will close on the sale sometime in the fourth quarter. We don't need to close from a funding perspective, but would like to continue our progress in selling down in Midwest markets when pricing and expected future returns are compelling enough.

In summary, we remain focused on executing our business plan, leasing space, prudently deploying capital into acquisitions and development to create value and recycling capital out of asset where we believe returns and growth will not be as attractive. We have great teams in the ground and I'm very pleased with the results that continue to deliver on behalf of DCT.

With that, let me turn the call over to Matt.

Matthew T. Murphy

Thanks, Phil, and good morning everyone. The third quarter 2012 was another very successful one at DCT in which we continued to see improvement in our operating metrics and success in pursuing our strategic initiatives.

Consolidated operating occupancy increased approximately 150 basis points during the quarter, and we ended at 91.8% our highest occupancy since the end of 2008. This increase was achieved entirely through leasing and properties we owned at the end of second quarter as opposed to being a result of any changes to the portfolio.

In addition, we have another 1.2% of our portfolio currently leased, but not yet occupied. We expect occupancy in our consolidated operating portfolio to be approximately 93% by yearend. Our same-store operating results continued their positive trend in the third quarter as well, increasing 2.7% on a GAAP basis and 4.3% on a cash basis. This improvement was entirely driven by revenues as average occupancy in the same-store pool was 120 basis points higher in the third quarter of 2012 versus the same period in 2011 and with higher effective rates.

Once again, the improvement we've experienced is very broad-based with 16 of our markets experiencing positive cash same-store growth in the third quarter and nine of those markets showing double-digit improvement. Based

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on these results, we're increasing our projections for 2012 same-store growth to 5% to 6% on a cash basis and maintaining our projections on a GAAP basis of a 2% to 3% increase.

On the capital markets front, we issued just under 19 million shares of common stock in early September through an overnight marketed offering. The proceeds of this offering approximately $112 million have been or will be used to fund the attractive acquisition and development opportunities that Phil discussed. We are very pleased with the participation and the offering, and the performance of our stock afterwards as we believe, it reflects our investors continued endorsement of our strategy and execution.

In terms of future capital deployment, we expect to close on an additional $100 million to $125 million of acquisitions during the remainder of the year including the $86 million airfreight acquisition, Phil mentioned earlier. We are also expecting to start construction on approximately $35 million to $50 million of development during the fourth quarter in Southern California and Houston, bringing our total starts for the year to between a $110 million and a $125 million.

Our capital recycling afterwards have also continued to play out according to plan through the year. Since December of 2011, we've acquired approximately a $117 million of existing buildings and spent approximately $73 million on development activities. During that same timeframe, we've generated proceeds of approximately $100 million from dispositions. So far, we have been quite effective in terms of match funding, which was one of the cornerstones of our business plan for the year.

Turning to funds from operations guidance. As a result of the strength, we've seen in our operating fundamentals combined with anticipated dispositions closing later in the year than previously expected and a better than anticipated cap rates. We are updating our 2012 FFO guidance to $0.40 to $0.42 per share, raising the bottom end by a $0.01 and the midpoint by $0.005. As many of you have likely noted, we have decided to provide our initial 2013 guidance in conjunction with our fourth quarter 2012 earnings release similar to other public industrial rates. This will be our standard practice moving forward.

I still alluded we are not currently experiencing any significant changes in leasing activity or tenant behavior. However, given the uncertainty surrounding the responsive businesses to the presidential elections and the impending fiscal cliff, we believe we will be in a much better position to provide meaningful insights into 2013, having seen the important result of fourth quarter leasing, as well as the implications of early 2013 renewals.

We feel that the additional clarify the next 90 days should bring, will allow us to provide much better direction regarding our leasing and capital deployment expectations for next year. In the mean time, we will continue to proceed how we have been, mindful of the macroeconomic uncertainties in the world today, and the risk they carry, but also a very much buoyed by the success, we have achieved thus far in a similar environment.

With that, I will turn the call back over to [ph] Su for questions. Thank you.

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QUESTION AND ANSWER SECTION

Operator: We will now begin the question-and-answer session. [Operator Instructions] The first question comes from Jamie Feldman of Bank of America. Please go ahead.

Jamie Feldman

Q

Thank you and good morning. I see the leasing spreads are positive on a GAAP and cash basis in the quarter. Can you talk a little bit about your outlook, I guess for as what happened this quarter that GAAP in there, and then, secondly, what's your outlook going forward for that metric?

Matthew Murphy

A

Hey Jamie, it's Matt. I think what happened in the quarter is that, we seeing a continuation of a trend that's continued for several quarters, we've always talked about the fact that this is a reasonably volatile statistics, as a mix impacts a lot in terms of both markets, in terms of the duration of leases, in terms of new versus renewal, and so, while I think you will see the general continuing positive trend in this as we've discussed in previous calls, I think it's going to be volatile quarter-to-quarter, but on an increasing trend over time.

Q

So, I guess do you have a sense of mark-to-market of the portfolio today?

A

Yeah, I guess I would say it's something that we look at from time-to-time, but it's hard, because it moves so quickly. I would think that we are generally in line with market in total with the leases in place today. May be still slightly below, but I don't think it's a material, I think it's probably within our ability, within the precision that we can calculate it, its effectively on market today.

Q

Okay, great. Thank you.

A

Thanks, Jamie.

Operator: The next question comes from John Stewart of Green Street Advisors. Please go ahead.

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John Stewart

Q

Thank you. Phil I think you mentioned that you had some additional leases out for signature on the pipeline, if those come to fruition what would that take the percentage leased from 40% to what?

A

I'd rather not pursue precision reasons and maybe other reasons that I'd rather not depend down and declare where they are or to what extent, but it certainly moves it up materially and we're optimistic.

John Stewart

Q

Okay, and...

A

Sorry, I wish I could answer the question, it sounds like it's the right kind of question to answer, yet until we get them done.

John Stewart

Q

No problem. And then on the Midwest assets that you mentioned you're auctioning, can you kind of give us a bit more color there and perhaps speak specifically to the buyer pool and interest in pricing?

A

I will, the buyer pool is fairly – was fairly broad-based. Pension funds, industrial funds. I'll consider industrial private equity funds where the primary bidders we had, there is a good demand. It reflects I believe a continued desire in the Midwest secondary type markets for quality. So, the fairway is narrow in general from a liquidity perspective. Pricing is okay, I will say kind eight to low eights for secondary Midwest markets, not saying where this portfolio is going to go, but in general I think it confirms that we kind of believe going into it. There are buyers, but that pricing gaps relative to primary markets are significant.

Q

That's helpful, thank you. And then lastly you said in the past that you don't really have interest in keeping a lot of land on the balance sheet, just maintaining a land bank for the purpose of inventorying land, but you have been more acquisitive here, I just wanted to – should we infer that the land that you're taking down you intend to build on in the immediate future?

A

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Yes, in each case both Seattle and Southern California, there is a significant process that needs to go through. So, we won't start construction until later in 2013, not for a lack of desire, but it takes time I guess it's the reason why they're called supply constraint markets, but there is no doubt that our intent is to build it soon. Now, in the case of Seattle, it's a good example where we said we're going to buy two phase projects where we build the first phase, and we're confident given market the depth of market demand and the strength of the market at the second phase is a good risk adjusted bet. So, we will not build both buildings at once in Seattle, just like we did in Florida. We built the first one, pre-leased it before we finished construction and then started the second one last quarter just before we finished construction of the first one. So I love that. That would be great if we can pull that off every time.

Q

Okay, thank you.

Operator: The next question comes from Brendon Maiorana of Wells Fargo. Please go ahead.

Brendon Maiorana

Q

Thanks. Good morning. Phil, I just wanted to follow-up on the Midwest assets that are being marketed. If I look at some of your Midwest markets, it appears that the occupancy levels just on average in those markets are below the average in the operating portfolio. But your comments sort of suggest that where there's interest, there would be stabilized assets, core assets. Is that – are you likely to sell assets with high occupancy or do you think you can get credit for some of the vacancy that's in there and do you think you sell some of the more vacant assets as well?

Philip Hawkins

A

Our general focus with some of your investors in particular is to sell stabilized assets. It's our belief there were – in most cases well served the first investor own effort into stabilizing them and then sell, given the spread particularly in those markets between value-add or an unstabilized versus stabilized assets. So you can expect us to sell primarily in those kind of markets will be stabilized assets. If we find a user, happy to sell to user, happy to sell to our investors who got a different view of the world than we do. So never rule anything out but in general, my belief is that we want to acquire assets with good upside and sell assets that we stabilize and people will value that stabilized cash flow perhaps more than we do.

Brendon Maiorana

Q

Sure. Now that makes sense and as you look at the market and leasing that – it seems like it got better from your comments in August and September, sounds like October is off to a good start. For some of those low occupancy assets, the low occupancy markets, is it – do you think that even the markets where you don't have a long-term strategy to stay in, do you think that you can get an occupancy ramp as you go into next year and beyond to get to stabilized levels or are those markets just kind of structurally challenged at this point?

A

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No, actually not. I think that the asset we have in those markets, where vacancy is, I use Memphis and Columbus as good examples. They are high quality Class A assets that -we believe will lease up in the near-term, whether that's three months or nine months, I don't know, but definitely not structural vacancy by any means, either based on the market or on the building themselves, it is simply, in my view a matter patience and effort, and we will continue to exercise both, hopefully well.

Q

Okay, that's helpful. Last for me, if we look at the lease economics, it look like CapEx levels moved up a little bit relative to your longer-term average on a per square foot, per year basis, but the rent spreads got better too. We don't know specifically what rent levels you got relative to the CapEx that you spend, but is it your view that rent to economics are getting better, when you look at kind of net effective rents, net of the concessions and free rent or is it our face rents moving up that you've got a little more on the concession level too?

Philip L. Hawkins

A

No -this is Phil, again. It's my view that they are getting better, not in a fast-pace, but the trend is positive. I think – we first saw improvement in the area of free rent concessions. Our free rent is down materially where we are half of a month per year of term in the third quarter. It's about where we were in the second quarter. Free rent has come down more than base rates have gone up. Our base rates have – in a number of markets have moved up, and then lastly, I'd say CapEx, TIs, et cetera have not moved down. I don't expect them to move down. It's unlike my recollection of the office world, for a TI to consider concessions. I think TIs in commissions particularly probably in the brokerage world are viewed as necessary. And, I think traditional and fairly typical for landlords to bear much of the brunt of that anyway. So, I think thing you've seen is concessions come down pre-rent. You're set to see [indiscernible] rates go up, and I think you'll see that more-and-more and lastly, maybe you'll never – you are not going to see a material drop in CapEx. You won't see a change of CapEx based on mix term, I mean so CapEx is going to move around, but in general I think that's the order I put them in.

Q

Okay. That's helpful. Thanks.

Operator: The next question comes from Craig Mailman of KeyBanc. Please go ahead.

Craig Mailman

Q

Hey guys. Just wanted a follow up on the sales side of things. Phil, as you look at the portfolio, you guys have done a nice job sort of repositioning, how much more do you guys – would you want to sell off the portfolio?

A

Well, it depends on what the price is. Everything is for sale in my company. We really look at things on a practical level. We will always be upgrading, recycling our portfolio to take advantage of what we see as our opportunities to invest our capital and our people's time into assets where they can create value and increase growth, and sell assets where that process has either happened or in our view won't happen. Suddenly it ever ends, I don't have a

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number on it, we are always actively pointing to our portfolio looking for ideas and opportunities, we're always open to ideas from unsolicited offers, brokers, users, so it'll never end. And I don't mean that to be a sort of overhang, it's just the business we're in, it should – we should actively manage our portfolio, now it changes during the cycle, as you get into various parts of cycle, that may become more or less active, but anyway there is no absolute end to that process.

Craig Mailman

Q

That's helpful, I get, certainly trying to get out, do you think you have enough debut into sell what we're pricing is reasonable to continue to sort of match fund, new investments, so do you think new investments are going to ramp enough to what you need to source other avenues capital.

A

No, I think we've got assets in this market where there are a plenty of buyers and actually buyers across a spectrum, it clearly gets thinner as you go into your lower quality assets in secondary markets, but I think there's plenty of depth in the buyer approval and opportunities that we see for us to continue to focus our portfolio and upgrade our portfolio from a financial return and growth perspective, that recycling will be an active part of our business plan for the near future.

Craig Mailman

Q

Okay, helpful. Then on the leasing front, it sounds like you guys have some pretty good activity so far in October, just curious, what percent – or if it's trending kind of with historic levels, what you're seeing on renewals and new activity on the month-to-month or shorter term leases versus a little bit longer term?

Matt Murphy

A

Yeah, hi Craig, it's Matt. I think actually, we probably started to see a shift when we talk about average term sort of on our leasing disclosure we exclude month-to-month leasing for I guess obvious reasons, but I will say that I think we have probably seen less of that than we certainly did a couple of years ago probably did even a year ago. And therefore more of the leasing that we've seen has had longer term. I think for sort of full term leases I don't think there has been a meaningful change in the term. It generally stays within a few months of five years by and large maybe a little shorter on renewals but I do think particularly larger users have made longer commitments and are doing perhaps the corollary to that is there's a little bit less three-month deals or short-term deals that are out there. I don't think it's significant enough to consider it a sea change, but I would say on the margins have probably has reduced.

Craig Mailman

Q

Okay, that's helpful. Then just one last one, I know it's a few months out here, but what's your thinking on $175 million of the unsecured notes coming due. Would you look to try to roll that or taken on the line?

A

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I think it's probably too big to take on the line and it is both too early to talk about it, not too early at all. It's a single note with a single lender that I think I've had casual conversations with and they have expressed interest without commitment on renewing it. I think, so I think there is a number of options, if it comes due and I believe it's June 6 of next year and so it's really kind of an early 2013, discussions but I do think pretty much the whole gamut is available to us. I think the taking into the line would be unnecessary and probably not the right usage of the line. I think we have a lot of options with it and obviously the market is pretty good these days.

Craig Mailman
Q

Yeah, I know it's early but you are in discussions how much of the rate reduction you think you can get from those 6%, where it is now?

A

Yeah. Well, it's 611, I would think – look to what the markets have done. We did on our last deal at 421 on a 10-year deal, I think probably spreads and rates are probably actually fairly constant, with spreads have come in a little bit from there. And so, I think – again, a part of it depends on what term we end up using, but for 10 years in the low fours certainly seems to make sense to me.

Craig Mailman
Q

Great. Thanks.

A

Welcome back, Craig.

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

Sheila McGrath
Q

Yes, good morning. There are some big moves in occupancy rates in the quarter and some of your top ten markets. And I was wondering if you could give us a little more detail on some of the bigger moves like in Atlanta, Northern California, Chicago and Memphis?

Matthew T. Murphy
A

So speaking of -- welcome back – welcome back, Sheila.

Sheila McGrath
Q

Thanks.

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Matthew T. Murphy

A

This is Matt. I think there is a couple of different things going on. I'll probably let Mike talk to Memphis. Northern California, we lost a little bit of occupancy. There's literally nothing over 50,000 square feet. It was a series of smaller transactions, still ended up at 95.4%. So I would consider that just sort of normal churn in the market. In fact, some of that was – I think 75,000 square feet of that was actually the explorations of short-term occupancy. I'm trying to walk through the markets again, I think I'll let Mike handle [inaudible]

A

Mike, once you handle Atlanta and Memphis. Real quick.

Michael Ruen

A

Yeah. Really to summarize the activity, the users where transportation were house related, you have to keep in mind in Memphis in particular, our spaces are typically large. So the movement is really contained and just really one building in Memphis, which was at East Park 1, where we did a deal with the transportation and warehouse company that brought that occupancy up, and in Atlanta, we did two large bulk deals, again both with transportation related groups, third party logistics companies.

A

Hey, Mike, I think she was asking why they went – why occupancy went down, so you...

A

Memphis was up and latter was down.

Sheila McGrath

Q

Yeah. I'm looking at your chart in your page 2 in the supplemental, so it's year-over-year, not sequentially, so maybe that's where a little bit of the confusion lies, but that's fair enough on Memphis.

A

Atlanta was actually a budgeted move out. So, it's just nothing that we won't prepare for Sheila.

Sheila McGrath

Q

Okay. And then, Phil, maybe you could just address on acquisitions, the first three quarters that you've worked for the active compared prior years for DCT, and I'm just wondering based on the current pipeline, if you think you will be on a equal pace to what – how active you have been?

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A

I think we're going to have a decent quarter on the fourth quarter without putting us [indiscernible] too deep into the ground. We've got a several deals that we're working on that were optimistic will happen. Honestly, they could be delayed a little bit with respect to Hurricane Sandy. So, I don't know what the impact has on that [indiscernible] our desire to buy or the seller is willing us to sell, but there – either East Coast assets and/or East Coast based sellers, and therefore that could have an impact. I feel good about the pipeline. It's not going to be anything off the charts in either direction. I think it's going to be like a decent quarter.

Sheila McGrath

Q

And is it all going to be one-off for you looking at any portfolio opportunities?

A

I will try to [indiscernible] how you define one-off, they are not, they are probably smaller than what we announced with respect to the air cargo acquisition. We are always working on something's that could be bigger, and you never know when they get traction and how fast they go. So we are not just working on one off, but those other opportunities, the larger ones, they're off market it will take time, there is always uncertainty and certainly unpredictability. So the one off what I'm talking off, one off and I see it, that might be a 4 billion portfolio in one location, but it sort of a one seller, one market type acquisition and we are working on several of those – none of them may happen and hopefully more than – then -- hopefully many will happen, but again, I want to put a stick in the ground too deep, because there is so much that can happen, but think can they can have them, but I think the third quarter is a pretty good indicator, where I think we can be.

Sheila McGrath

Q

Okay. Thank you.

Operator: [Operator Instructions] Our next question from Jamie Feldman of Bank of America. Please go ahead.

Jamie Feldman

Q

Great, thanks. I was hoping you guys could talk a little bit more about the leasing pipeline and demand pipeline. I guess specifically, your latest thoughts on e-commerce and the level of demand will continue to see from there, and how much that can continue a warehouse recovery? And then secondly, you've commented using some signs, some pickup from the housing market. Exactly what are you seeing, and what type of tenant and what market and kind of what are your thoughts there?

Philip L. Hawkins

A

Hey, Mike. You want to add some color, in terms of what you are seeing, and what you are hearing from the rest of the country?

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Matthew T. Murphy

A

Sure, Phil. Obviously, from the e-commerce standpoint, you've got a quite a bit of activity that has been driven primarily by the pure play guys. But we are also now seeing the traditional brick-and-mortar guys ramping up and they are taking down space and the needs are driven primarily because they're their current supply chains don't fit within the mix of what they're doing in the box. With respect to the smaller users in the market that we're saying, some have been driven by the housing pickup in particular and we're seeing some foreign contractors that have picked up in suppliers. We've seen electrical suppliers picking up primarily end markets where we're seeing more housing starts like Northern Virginia, Houston, and Dallas.

Operator: The next question comes from John Stewart of Green Street Advisors. Please go ahead.

Erick Frank

Q

Hi, this is Erick Frank for John Stewart. Could you guys – I know you guys have some pretty good performance across portfolio in terms of occupancy growth. But [inaudible] Phoenix hold a bit looks like there is some occupancy drop there, and it looks like that new acquisition you made a few couple quarters ago, it seems that you loss that tenant, can you just go through that little bit further?

Matthew T. Murphy

A

Hey Erick, it's Matt. It's actually your dead on the part of [indiscernible] that the building we bought had a – it was a sale-leaseback but on a very short-term. So it was known when the day we bought it, that they were going to move out on that asset had drop in redevelopment, which impacted Phoenix's occupancy. The other one is a 150,000 square feet space that was a food distributor that we have signed a lease for with another food distributor that will move in before yearend. So it has been backfilled, but frankly contributed, it was as pretty good financial transaction, it actually contributed lot to the positive rent growth, also contributed frankly to somewhat higher capital, because it did ever freeze your cooler element to it, but you'll see Phoenix rebound almost back to where it was by year-end based on activity that's sort of in-hand today, we're also the next biggest vacancy there is some serious discussions going on 90,000 plus square feet there, so it is part of a planned reduction, i.e. either sale leaseback building but also just a sort of reloading on the 115,000 square feet.

A

That – so leaseback building, we're going to say leaseback as more of a temporary or combination to the seller who was moving into a larger quarter, that building is now under construction. We're redoing the entrance, we're redoing a fair amount to the project and we've got, what I'm told is will be good foot traffic through there in terms of showing. So, we're feeling pretty good about it, but nothing signed.

Erick Frank

Q

Okay, thank you. And since, obviously you guys have been super active on the development front and looking for new land projects we hope to get under construction pretty quickly, can you just talked about the competitiveness of finding good pieces of lands and whether you have, where the competitors are really bidding up land prices in terms of other REITs there are other buildings out there?

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A

Well you're seeing a definitely more competition for land today than you did six months ago or a year ago. The sites we've acquired this quarter, we've been working on Seattle for well over a year, actively working on, not just following. And then Slover II, which was a multiple seller assemblies which took local expertise and frankly some experience in that area was fortunate, but in general if you've got good sites, it could be of their entitle or close to entitle that's a little bit easier to do in markets that are fairly well accepted as strong markets, Southern California, Seattle, Miami, Houston, there's no doubt that competition's up, prices are up, our focus is I think we got ahead of the cycle and we've got – we're comfortable with the land position we now have. And then we now have and then we are continuing to look at those sites where we can bring a little something that maybe the others who don't have the same kind of balance sheet or expertise can do it into assemblage, the willingness to go through entitlement process which takes time. We don't think we're taking much risk there. This takes effort and time, but there is no doubt that there is more capital flowing in if non-traded REITs and pension funds to commence with private developers, it's obviously the public REIT, but that's not new. And then you've now got so that's – that's where the competition is coming from.

Erick Frank

Q

Great, just I guess one last point on the development front, could you probably talk about balance sheet strategy in terms of development obviously developments by nature are more riskier asset allocation strategy just trying – I'm just curious about, how you would plan to fund that in the future in terms of maybe an ATM program to match funds in terms of equity?

A

Yeah, this is Matt. I think I guess fundamentally our development program we don't fund it any differently than we do any other part. These are assets that we intend to develop at own long term. And therefore they have sort of fall into the normal capital stack. The ATM obviously can work well and that you've seen other people do that. We frankly have been focused thus far on utilizing disposition proceeds that have funded in a pretty efficient match funding way with all of our expenditures including both acquisitions and development. Obviously, we got a little bit out ahead in terms if you will in terms of funding needs with the equity offering. I think that's quite honestly pretty prudently consistent with the increasing development activities. So, hopefully what we'll do is manage opportunities and sources of funding while being very cognizant of balance sheet credit metrics if you will, and an eye towards the horizon not just where you are today. So I don't think its fundamentally any different than any other part of our business.

Erick Frank

Q

Okay. Thank you.

Operator: The next question comes from Brendan Maiorana of Wells Fargo. Please go ahead.

Brendan Maiorana

Q

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Hi, thanks. Phil, just I had a follow-up, hearing your comments about the Midwestern markets and sort of narrow fairway where buyers are interested in. Have you seen movement in B products pricing in more of the primary markets or value add pricing? Is that tightened relative to the A, the core stuff, which has been pretty strong over the past 12 months or so?

A

The answer is yes, if you define B, as good quality functional asset. B is an overused letter. If you've got good functional 24 foot decent truck core assets in primary markets, you definitely seeing a lot of buyer interest and therefore [indiscernible] compression. If B is a fancy word for a lousy product that I would call a C, no, you see no change. Investors are pretty smart, pretty savvy investors. They are focused on product that will work in the medium and long-term. There are some but I haven't see a lot of transactions, but that of sort of bottom fleeted if you are looking for that dysfunctional asset, maybe we can get lucky on in it terms of timing, but for the most part, the buyers are looking for functional real estate. They are not just looking only at Class A brand-new product in primary markets, but they are willing. We're willing to buy all those assets that are not – that are very functional in-fill type locations. So those cap rates have definitely come in and I'm not surprised by that. I'm not surprised by the fact that the other assets are tougher to sell and probably will remain so for a while.

Brendan Maiorana Q

So that's largely been kind of my view is that's largely been the cross-section of assets that you guys have been focused on kind of maybe not the brand new building, but the highly functional building in a good location. So is that – is it becoming more challenging for you to acquire, because it looks like your acquisition pace has been – has continued to be pretty good?

A

Yes, more challenging. We've been fortunate. I'd say cap rates have come down if you look at our own metrics. They have come down. I would rather achieve a higher cap rate, but I'm happy with the cap rates and their returns we're buying. They've come off market with some -that's not the asset, but some motivation of the seller that helps us. We were happy to buy Class A brand new assets and the airfreight assets we bought the 3 in LA and that one in Chicago are absolutely Class A modern facilities. We bought a number of Class A modern facilities across the country, but we are very happy buying in-fill Class B, maybe I should say B plus or A minus that I'm trying to spin it, but assets at a very functional we think will be very functional for a long time.

Brendan Maiorana Q

Sure, okay. Thank you.

A

And by the way the other thing I would add is we want to take on leasing risk, which there is plenty of capital that's willing to do that, but still the vast majority of capital is looking at stabilized assets. We're not the only one who wants to take on vacancy risk, but believe me, but it's a little bit shallower of approval not shallow, but shallower of approval than the traditional kind of pension fund, non-traded REITs looking to stabilize assets.

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We're willing to take on vacancy risk. We're willing to take on redevelopment challenges and renovation challenges. We're willing to work for it not just to find somebody else's product that fits kind of the box.

Operator: [Operator Instructions] There are no further questions. I'd like to turn the conference back over to Phil Hawkins for any closing remarks.

Philip L. Hawkins

Well, thanks everyone for participating in today's call. Especially again those of you who are listening in or even reading the transcript that are dealing with the impact of hurricane Sandy on your families, homes and businesses. I hope your recovery process goes as well as humanly possible. We look forward to seeing many of you in a few weeks and hope to see and touch and update you again in 90 days.

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

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