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DCT Industrial Trust, Inc. (DCT)

Q2 2013 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning, and welcome to the DCT Industrial Second Quarter 2013 Earnings Call 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 Ms. Melissa Sachs, VP, Corporate Communications and Investor Relations. Ms. Sachs, please go ahead.

Melissa Sachs Fitzpatrick

Vice President-Corporate Communications & Investor Relations, DCT Industrial Trust, Inc.

Thanks, Laura. Hello, everyone, and thank you for joining DCT Industrial Trust second quarter 2013 Earnings Call. Today's call will be led by Phil Hawkins, our Chief Executive Officer; and Matt Murphy, our Chief Financial Officer, who will provide more details on the quarter's results as well as our guidance for the balance of the year. Additionally, Neil Doyle, our Managing Director for the Central 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 limitations, statements regarding projections, plans or future expectations.

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

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

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

Philip L. Hawkins

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

Good morning, everyone, and thanks for joining our call. We had another good quarter, leasing activity was strong and we acquired a number of excellent assets with good NOI and value growth potential. We also continue to make significant progress with our development program in terms of growing the pipeline as well as leasing these assets. Leasing remains active with occupancy and lease economics continuing to gradually improve across all markets. Also important, small tenant leasing activity, which picked up noticeably last quarter, remains brisk.

While new supply is increasing, it is still modest relative to existing inventory, tenant demand and historical averages. Just as important, developers remain disciplined with respect to both starts and leasing decisions, driven at least in part by the fact that virtually all of the capital funding development is coming in the form of equity rather than non-recourse debt as in past cycles.

While Matt will go into more detail, key second quarter operating metrics included, we signed 4.4 million square feet of leases during the quarter and an additional 1.6 million square feet in July. Our leasing people are busy and upbeat about tenant activity, and we have a good pipeline of leases currently under negotiation.

Same-store increased 4% on a cash basis and 1.9% on a GAAP basis. Re-leasing spreads increased 3.7% on a GAAP basis and decreased 3.8% on a cash basis. And occupancy in our consolidated operating portfolio was flat on a same portfolio basis after adjusting for acquisitions and dispositions during the quarter.

While our market teams continue to make outstanding progress repositioning our portfolio through development, acquisitions and dispositions, we're focusing on high quality assets in in-fill locations with above average growth and value creation prospects. During the quarter, we closed on $157 million of acquisitions including the previously announced $83 million acquisition of a joint venture partner's 96.4% interest in a 7-building portfolio.

On average, including the JV acquisition, these assets were 81% occupied at the time of acquisition, reflecting our bias towards value creation and NOI growth potential. Leasing of these recently acquired assets is ahead of plan, as they are now 95% leased with all the increased occupancy occurring in July and early August. We have a strong pipeline of acquisition opportunities in which we are working, which led us to increased acquisition guidance for the year, which Matt will discuss in more detail.

The most exciting value add opportunity that we acquired in the second quarter actually looks like a stabilized asset in the earnings release because it is 100% leased. Located at 4800 South Central Avenue in Chicago, it is comprised of an 850,000 square foot industrial building and a separate 22 acre container yard. It is located in one of the premier in-fill locations in this market on I-55 equidistant from downtown Chicago and I-294. The seller will lease the project and continue operating his business through 2015, during which time we will be working on plans and approvals to redevelop the 47 acre site with new state-of-the-art distribution buildings.

In addition, the reconstruction of the adjacent I-55 interchange which serves the site is well underway and will be completed in 2014. Several other interchanges along I-55 have yet to be redone, a competitive advantage for this location. We bought this site for $7.35 per land foot, which compares very favorably with recent transactions, plus we will receive a 7.2% return in the first year with 2.5% annual rent bumps while we go through the planning and approval process. Neil Doyle, Managing Director of our Central Region, is on our call this morning and can answer any questions you might have as he worked closely on this deal with Brian Roach, who runs the Chicago market for DCT. They did a great job sourcing and creatively thinking through this opportunity.

Moving on to development, we now have $137 million of projects under development, which are 52% leased and expected to generate a year one cash yield of 7.5%. We started construction in the second quarter on the 100,000 square foot 8th & Vineyard Building B in the Inland Empire West submarket of Southern California. We expect to start an additional $145 million to $170 million during the second half of the year, including the fully pre-leased 610,000 square foot Slover Logistics Center II and 928,000 square foot DCT Rialto Logistics Center, both located in the Inland Empire West submarket of Southern California, and our 650,000 square foot DCT White River Corporate Center 1 and 190,000 square foot DCT Sumner South Distribution Center both located in the Kent Valley submarket of Seattle.

Also in the Kent Valley, we signed a lease and are in the process of finalizing the acquisition of the land site for a 49,000 square foot build to suit in Auburn, Washington. Construction should start in the third quarter with occupancy commencing late in the first quarter next year.

Knowing that at least few of you are interested in the status of DCT 55 in Chicago, I am pleased to report that we are in the final stages of completing a lease for half of the 600,000 square foot building with excellent activity on the balance of the space. We have more work to do to cross the goal line but feel good about our prospects for this project's success in terms of timing, rental rates and tenant credit.

We remain focused on recycling capital, selling lower growth, non-core assets when we believe the proceeds can be reinvested at higher long-term returns via development and acquisitions in our core markets.

In the second quarter, we closed on our remaining assets in San Antonio at a cap rate in the low 8% range. They are older Class B buildings in which we had just completed the lease up to 99% and believe that value had been maximized.

And as we announced last week, we have entered into a contract to sell all of our Mexico assets for a price of $82.7 million. This translates into a year one return of 7.7% after taking into account the leasing capital associated with several recently assigned leases for which the buyer assumes responsibility. Once we close on the Mexico transaction, we will have exited a total of 10 markets and we'll be 100% focused on major distribution markets in the United States. We have several other buildings on the market and continue to be encouraged by market conditions, buyer depth, and pricing. To-date there appears to be little to no change in buyer behavior or pricing in response to run up in interest rates.

In summary, we are making great progress and I am excited about our prospects for continued strategic, operational and capital deployment success. The markets remain supportive and our market teams are doing a great job sourcing opportunities and creating value.

With that, let me turn it over to Matt to provide further details on our results for the quarter as well as our updated 2013 guidance. Matt?

Matthew T. Murphy

Chief Financial Officer & Treasurer, DCT Industrial Trust, Inc.

Thanks, Phil, and hello everyone. I will talk to our results for second quarter and discuss the progress on our capital plan. I'll also update our guidance and outlook for the remainder of the year.

Our second quarter results continue to reflect the progress we're making in the field and the constructive market fundamentals in our business. While our headline occupancy is down 80 basis points for the quarter, all of this decline was caused by selling 1.6 million square feet that was 99% occupied, and acquiring 3.8 million square feet that was 81% occupied during the quarter. On a same portfolio basis, our consolidated occupancy remained flat which was slightly ahead of our internal projections. In addition we had over 600,000 square feet of space that was leased but not occupied at June 30. This equates to 1% of our consolidated operating pool. All but 50,000 square feet of this space is now occupied.

Leasing was strong in a quarter as we signed approximately 4.4 million square feet and tenant retention returned to more levels at 67.1%. More importantly our market leaders continue to feel good about the leasing markets and the outlook moving forward. Given all these factors, we continue to feel optimistic about our year end target of 93% operating occupancy although it's likely that the majority of this pickup will occur during the fourth quarter as occupancy should remain relatively flat during the third quarter.

It should be noted however, that this guidance does not contemplate the potential effect of any future acquisitions or dispositions beyond the previously announced Mexico disposition. From a same-store perspective we had another good quarter. Second quarter same-store NOI increased 4% over 2012 on a cash basis driven by revenue growth of 6.5%. Average occupancy in the same-store pool increased to a 130 basis points while free rent and other concessions continue to decline in all of our markets.

This revenue increase was partially offset by $2.1 million increase in operating expenses primarily caused by property taxes. GAAP NOI increased 1.9% versus the second quarter of 2012. On a year-to-date basis same-store NOIs increased 3.5% on a GAAP basis and 6.2% on a cash basis, 17 of our 21 markets have experienced positive cash same-store NOI growth with nine of those markets experiencing double-digit growth.

Turning to the balance sheet, our capital plan remains on track, we had a very active quarter on the investment front closing on $157 million of acquisitions and investing $35 million on our development business. This includes the acquisition of 45 acres of land in Houston which will allow for the development of three buildings representing almost 900,000 square feet in the targeted north and Northwest submarkets. When added to the $53 million we spent on acquisitions and developments in the first quarter, our total expenditures for 2013 stand at about $245 million through the end of the second quarter.

Consistent with our strategy over the past couple of years, this activity has been funded by a combination of dispositions and equity issuance. We sold a little over $75 million of common stock in the first and second quarters through our ATM programs and have completed year-to-date disposition of a little over $110 million. When combined with the announced $82.7 million disposition of our Mexico portfolio, our sources of capital so far this year are well matched with the attractive investment opportunities we've been able to uncover.

Given our success in sourcing investment opportunities, we are increasing our acquisition guidance by $100 million to a total $250 million to $350 million expected for 2013. We are also increasing our expected development starts to $200 million to $225 million including projects already started this year. We will continue to fund these activities with disposition in equity, and a sequence and mixed based upon market conditions.

With respect to funds from operations for 2013 we have narrowed guidance by $0.01 at each end to $0.42 to $0.45 per diluted share leaving the midpoint unchanged. I think the best way to summarize the progression of guidance since last quarter is that better than expected operations both from an occupancy and rental rate perspective have essentially offset the greater short term dilution caused by the increase in our expected disposition activity during the year. While this may appear to be threading water from an FFO perspective we clearly view this as a positive as we continue to upgrade our portfolio as well as NAV and cash flow growth characteristics.

With that, I will turn it over to Laura for questions. Thank you.

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] . And the first question will come from Jamie Feldman of Bank of America Merrill Lynch.

Jamie C. Feldman
Analyst, Bank of America Merrill Lynch

Q

Great. Thank you. Good morning. Phil, going back to your comments on supply not being a major concern can you just talk a little bit more about that are there any markets where may be we should be watching a little more than others and what gives you comfort to hear that, this recovery is not gonna, it's not gonna throw some water on this recovery?

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

A

Well certainly its right – it's the question to be thinking about and monitoring, supply is up some six months ago for sure. Still in every market well below historical levels but also very manageable relative to current net absorption and also relative to current stock, inventory stock. Markets where developers and money are flowing the fastest, are the ones I'd be watching not would be, I am watching, Houston, Eastern and Central Pennsylvania where large buildings, it's not a lot of buildings but, it's a few big buildings. Phoenix sticks out to me as a market where there has been a lot of construction and lot of big box construction and in a market where I'm not sure, big box demand is as normal as the Inland Empire for example. Those are a couple of markets that stick out to me.

I still think even in those markets relative to demand and relative to stock, I still see – I am still encouraged but I do know there's other projects that could go, and if they do go, without leasing of the existing projects under construction or available that would cause some scratching of your head. To me, what gives me some hope and to say, that I'm not concerned, of course I'm concerned, you've got to watch it. But it gives me some hope as again it goes back to way this is being funded which is equity and equity investors, whether it be the developer themselves who have a balance sheet, i.e. the public REITs and maybe a few others or private developers who have pension fund, non-traded REIT and other similar type of forward equity or joint venture equity type structures. Those – that decision making is much different than a developer who has lots of upside from high leverage and fairly limited downside with non-recourse loans, that isn't happening.

Jamie C. Feldman
Analyst, Bank of America Merrill Lynch

Q

Okay, thanks. And then just a follow-up on that, as you think about your portfolio and your strategy within your markets I mean I guess you specifically how do you think you're protected from new supply or is there anything unique about your model that's going to hold things out longer for you guys?

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

A

Well, first I think where we had development going on I feel really good about it. Seattle, there's very little under construction and it's very difficult to get going there. We have a very unique project – actually several of them that are I think market leading. Inland Empire there is almost no vacancy in large bulk buildings in the West – be actually in the whole market. So I feel really good about that – 6 million square feet under construction in a huge market with incredibly strong demand and we have some of the bigger buildings which is where the demand is in the – and the best locations in the West.

Houston, we do one building at a time. They're fairly small and they're right size for that market, leasing is great. If leasing momentum slows we'll pause to me what – I'm not sure it's unique about our model but it's important about our model two things. One is we're building one building at a time of each size. And two, we're not taking on a large land bank. We can pause without significant economic pain, which allows us to make a more rational decision I think when it comes to development.

Jamie C. Feldman
Analyst, Bank of America Merrill Lynch

Q

Okay, thank you.

Operator: And our next question will come from George Auerbach of The ISI Group.

Operator: I believe there is a problem with phone I wonder if you could try speaking again we're having troubling hearing you.

George D. Auerbach
Analyst, International Strategy & Investment Group LLC

Q

Great sorry about that good morning. Phil you mentioned that you haven't seen any back up in secondary cap rates yet I guess first of all have you been surprised that you haven't seen an impact on pricing given the rate move. And two have you and to what degree will you change your strategy on dispositions based on your thoughts on this rate move?

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

A

Couple things one is not surprised but I certainly was worried about a lot of things when I saw rates pop with nobody really saw that coming when it happened. We all know rate increases are coming but no one saw it happening, you never know how buyers react. And I know how we reacted which is more cautious, deals on the margin when we think about buying we were certainly thinking about it a little differently the day after Bernanke started getting people thinking about this and the markets reacted. There is so much capital and I think the rationale for people looking in the secondary markets has been chasing higher yields and that rationale may be just as strong, if not even a little stronger when you are in an environment where interest rates are coming up. You've got more cushion. We're actually seeing there is more interest in secondary markets today than there was three months ago more investors interested in Columbus as an example.

So I'm not surprised, but I wouldn't have been surprised the other way either.

George D. Auerbach
Analyst, International Strategy & Investment Group LLC

Q

Okay thanks.

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

A

And I'm sorry the other question you asked was I'll save your follow-up for a real follow-up if you want it, was how does it affect our disposition strategy?

George D. Auerbach
Analyst, International Strategy & Investment Group LLC

Q

Yes.

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

A

Our disposition strategy is asset specific and price sensitive. I know we were successful in exiting, well contracting exiting Mexico but because of pricing that we thought was attractive relative to our opportunities elsewhere and in San Antonio. But to me we will sell what people want to buy. And we're going to try to sell fully leased assets or where we sell vacancy is to a user for a project that we just aren't skilled enough to take any further. So I'm not sure the change in interest rates has any affects on our disposition strategy other than, we're paying attention to each individual market and each individual asset and it's a dynamic world and I'm sure that, it will unfold a little differently than we expect it to.

George D. Auerbach
Analyst, International Strategy & Investment Group LLC

Q

Great, thanks Phil.

Operator: And the next question is from John Stewart of Green Street Advisors.

John J. Stewart
Analyst, Green Street Advisors, Inc.

Q

Thank you. This might be for a combination of Phil and Neil but clearly we saw some tangible progress on the portfolio repositioning during the quarter with Mexico and San Antonio and, so I guess the question is, number one, Phil can you remind us, where you're headed in terms of target number of markets and then, Neil could you maybe weigh in on the Midwest strategy and touch on DCT 55, lease up relative to underwriting?

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

A

Okay, well thanks for asking a question for Neil, he will appreciate that. I think about it more as a percentage of total portfolios – at this point, we are close to our original target of 20% of our assets in non-core markets, non-focused markets. Now we may adjust that target or go beyond that target but when we started this program, we were, that's about how, that's how we're thinking about it. We don't need to be pure, we just need to be more focused and weighted towards markets that we like. Today, honestly the markets we're in the U.S. they're all doing well. We've got an operating platform that has proven its ability to lease in those markets.

The markets that probably people like the least are where there is less development going on so its actually a lag going to the recovery but today that recovery is actually more accelerated and accentuated in those markets than maybe even on the coast relative to market rental rate growth and occupancy growth. So I'm in no hurry from here I really think about it on an asset-by-asset basis today versus a year ago or two years ago I was thinking about it both ways. And I say I, we were thinking about it both ways. There is definitely benefits to concentrating in the portfolio but then there is more benefits right now from an asset perspective. So we'll continue to look at it on asset-by-asset basis I don't see any major kind of market exits in the horizon but hopefully I'm wrong. Neil why don't you answer the rest of John's question?

Neil P. Doyle
Managing Director-Central Region, DCT Industrial Trust, Inc.

A

John relative to, I'm going to walk you through the four Midwest markets less Chicago and then we'll get to Chicago with DCT 55. But Cincinnati is doing very well for us probably because not only Cincinnati picked up and looking at lowest vacancy rates since 2007. But I think what has picked up for us in Cincinnati is the small users have come back that's really helped our portfolio. Louisville is very solid market overall and a very solid market for DCT as you're essentially a sub 4% vacancy there. Indianapolis has sort of been the story of this year I think for everyone where you were sub 5% vacant three or four months ago, now as all of the spec has started that number is going to rise to 7% or 8% what has still been pretty solid for our portfolio as well as everyone overall.

The one outlier here a little bit for us is Columbus and that simply because we have one asset in Columbus we struggle with and not due to quality not due to location simply the demand in Columbus to-date has been a bit anemic but there is some activity. There is about 1 5 million square feet under construction of that 400,000 square feet is spec. So hopefully people are starting to believe in Columbus again and we'll see some more activity.

Moving up to Chicago and targeting DCT 55, Chicago sort of holds its own; vacancy is 8.6% 8.7%. We've had almost 5 million square feet of net absorption this quarter. Probably the story is construction, of the deliveries in the quarter about 2.5 million square feet, 1.6 million square feet of that was one single build to suit for Home Depot. So construction has been relatively muted they have been certainly disciplined which leads us to DCT 55. As you know that building which Shell completed earlier this year, as Phil mentioned in the one yard line of finalizing a lease of half of the facility. I'll tell you its meeting all our expectations relatively to the quality of the tenant, the term and the rents. And activity has been excellent really for second half and with that long story short is John is that the activity has swirled a bit from the 600,000 square feet user, 700,000 square feet user, 800,000 square feet user down to really 300,000 square feet user, that's is active in Chicago and fortunately that's who we have the product to accept. I hope that answers your question.

John J. Stewart
Analyst, Green Street Advisors, Inc.

Q

Yeah very helpful. Thank you.

Operator: And our next question will be John Guinee of Stifel.

John W. Guinee
Analyst, Stifel, Nicolaus & Co., Inc.

Q

Okay, thank you. Two questions-John Guinee, I think it is-first, is Jeff around?

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

A

No. Jeff is not on the call.

John W. Guinee
Analyst, Stifel, Nicolaus & Co., Inc.

Q

Okay. As you know Phil on the development side markets tighten, developer show up little bit like lo custs, land prices which is just a plug figure in a development pro forma go up exponentially; can easily double. So the question for you is, if you look over the last few years where you have seen significant increases in land price is one question? And then second question for Matt drill down a little bit more on the increase in OpEx and is that here to stay?

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

Means I'll start John with land prices, land prices in many markets have not moved much. Now they didn't go low either when I say haven't moved much there weren't in a lot of trades in 2008 and 2009, 2010 in even 2011. I used the Inland Empire though – where I think land prices have moved the most is in the Inland Empire. Where we bought some land in 2008 it was early 2009 in Rancho Cucamonga that was abnormality where we bought it for $6.5 a foot. But we've bought our Slover land for say $10 a foot roughly, land foot and today I'd say that the net land right now is priced $14, $15 a foot for land that's trading. Houston has moved up some obviously, but it's not 50% probably it down 25% and you're right land prices move up as confidence in the ability to put it in production grows and as rents grow. But that hasn't and you're seeing more demand for land so it's more competitive which will, I think lead to further increases in land, as we go forward. Matt?

Matthew T. Murphy
Chief Financial Officer & Treasurer, DCT Industrial Trust, Inc.
A

With respect to the increase in OpEx, there's really two driving factors of that, the biggest by far, the single biggest increase, has to do with property taxes, quite honestly predominantly driven by Texas. We just got reassessments on those. So what you're seeing in the second quarter is a little bit amplified because it's a catch-up for more than just the second quarter. I think quite honestly you have seen valuations go up in Texas. We will protest those, we will win a certain part of it, but I do think with valuations going up, property taxes are going to follow to a certain degree.

The other part that's probably a little bit more fleeting has to do with the fact that you've got increase in cam in the second quarter of this year, particularly in relation to last year. Some of that is, over the course of a year you see those numbers pretty stabilized. They will spike as activity spikes. You get a couple of big sort of roof repair projects, it will spike.

So I think, at the end of the day I think it's likely that property taxes will continue to increase in certain markets as valuations have. So I think in that regard, it's here to stay, it's probably a good bad, if there is such a thing, and other parts that I think are little bit more cyclical and related to timing.

John W. Guinee
Analyst, Stifel, Nicolaus & Co., Inc.
Q

All right, you had me until you said good bad. Can you explain that?

Matthew T. Murphy
Chief Financial Officer & Treasurer, DCT Industrial Trust, Inc.
A

Well, we're pretty long on real estate, so the fact that property taxes are going up because valuations are going up, that's ultimately a painful reflection of a very good trend.

John W. Guinee
Analyst, Stifel, Nicolaus & Co., Inc.
Q

All right, thank you.

Operator: And our next question is from Craig Mailman of KeyBanc.

Craig Mailman
Analyst, KeyBanc Capital Markets

Q

Hey, guys. Just wanted to go back to your comments that's small tenant leasing is coming back and I heard the comment that Cincinnati's benefited. Could you maybe just outline which other markets could see the biggest benefit in the near term and then possibly break out on the occupancy side sort of what the vacancy or occupancy is for space of 50,000 square feet and less versus your larger boxes?

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

A

Other than Southern California where we own a lot of good sized boxes and the vast majority of the tenants that we are looking for are large and Houston where there's a lot of small tenants but it's full and it's been active for a long time, every market needs small tenant leasing to remain strong. Maybe I guess Columbus we've got one large box space and we don't worry about Columbus from a small tenant perspective. I just like to have a large tenant show up. I think it's every market. Assuming the homebuilding-dominated markets are the most in need, Atlanta, Orlando-New Jersey, we've got a number of smaller tenant spaces, and a lot of this, a fair amount of small and medium size tenants. I mean there's not a market other than what I have listed that I would exclude from that.

Matthew T. Murphy
Chief Financial Officer & Treasurer, DCT Industrial Trust, Inc.

A

And then with respect to the specifics, we're right, just a little bit under 90% in our 50,000 square feet and below. And to give you sort of a sense of perspective, that's about 500 basis points, a little bit more, increase than it was a year ago at this time.

Craig Mailman
Analyst, KeyBanc Capital Markets

Q

Yeah, but was it the peak, by any chance?

Matthew T. Murphy
Chief Financial Officer & Treasurer, DCT Industrial Trust, Inc.

A

Not in front of me. My guess is the reason for that is that the data that I'm looking at doesn't go back far enough into the peak that would have been in 2007, 2008. It's going to be representative of overall occupancy, would be my guess, which is probably a little bit lower than an institutional quality portfolio like a public REIT which may stabilize in the 95% range. Smaller spaces probably churn a little bit more, so it might be 94%, but that's speculation, not fact.

Craig Mailman
Analyst, KeyBanc Capital Markets

Q

Okay. And then just a follow-up, on your comments on expenses this quarter, just looking at same store you guys above the high end of the range for the year. What's going to drive the back half to be that much lower? Is it just an incremental benefit from occupancy gains wears off or is there is something else going on?

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

A

When you're asking sort of what the back half of the year looks like, you...

Craig Mailman
Analyst, KeyBanc Capital Markets

Q

Yeah, because you guys aren't changing your guidance, right you're still 3.5% to 5.5%? But you're at 6.2% right now. Kind of what gets you to the midpoint of the range now, or could we see the kind of the guidance target maybe move up next quarter?

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

A

Well, obviously we're not going to talk about changing, potential changes in future guidance, but I think the short answer is, occupancy increased meaningfully during 2012 and therefore the comps are getting higher. I think that is being, the impact of that is being mitigated, if that's the right word, to some extent by the fact that rents are moving up quite a bit, and you're getting, without occupancy, you're getting free rent and concession burn offs that I think is a trend that continues in the future. So I mean I think it's simply algebra at that point that the increases will come down a little bit as a result of the fact that the back half of 2012 occupancy was higher than the first half.

Craig Mailman
Analyst, KeyBanc Capital Markets

Q

Great. Thank you.

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

A

Thanks, Craig.

Operator: And our next question is from Brendan Maiorana of Wells Fargo.

Brendan C. Maiorana
Analyst, Wells Fargo Securities LLC

Q

Thanks, good morning. So, Matt, I wanted to follow-up on that because your comments earlier in the call in the prepared remarks, I think you said operationally you guys were ahead but you're selling more in terms of assets so that guidance midpoint and from an FFO perspective stayed the same. So that sort of led me to believe that you're running ahead on same-store. Is that correct? I mean I can appreciate kind of the challenges in the back half of the year just running against part of comps, sounds like maybe you're trending on better on NOI then you thought at the beginning of the year when guidance was given?

Matthew T. Murphy
Chief Financial Officer & Treasurer, DCT Industrial Trust, Inc.

A

Yeah well I think we've increased it; we have obviously increased it on the back of the increased same-store numbers in the first quarter. What I said was we were slightly ahead of occupancy as of 6-30-13 and that better operations have offset the increased short-term dilution from the increased disposition activity. We have a range of same-store and I still think that even with that increase the expected outcomes fall within that range. So I think all of those are true. They don't every single piece, every time a single piece of that moves doesn't move all of them because we have ranges and we have ranges we know pieces of it will move.

Brendan C. Maiorana
Analyst, Wells Fargo Securities LLC

Q

Yeah no okay got it. And then just occupancy I just wanted to make sure that I understood this correctly. So you're occupancy as targeted by year end is 93% on the operating property so that's up from 91.9% today but that's inclusive of the sale of the Mexican asset which are 100% and are probably 30 basis points dilutive to the occupancy number?

Matthew T. Murphy
Chief Financial Officer & Treasurer, DCT Industrial Trust, Inc.
A

That's exactly right. I don't know about 30 basis points haven't done the math but it sounds about right the rest of it was exactly right.

Brendan C. Maiorana
Analyst, Wells Fargo Securities LLC
Q

Okay great thank you.

Matthew T. Murphy
Chief Financial Officer & Treasurer, DCT Industrial Trust, Inc.
A

Thanks Brendan.

Operator: And then the next question comes from Paul Adornato of BMO Capital Markets.

Paul E. Adornato
Analyst, BMO Capital Markets (United States)
Q

Good morning. Just a follow up on the large tenant, small tenant discussion and that is how do you look at your overall portfolio in terms of large tenant versus small tenant, do you feel like your are properly positioned in that regard?

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

From a large tenant perspective what we try to do is have a portfolio that can be multi-tenanted and whose size – and the size of those spaces would be not considered extraordinarily large or small. We have some flexibility that's left in the portfolio that I don't think are good fits for us long term, very small percentage of the portfolio, but clearly catering to real small tenants in a higher office finish than we are comfortable with and frankly equipped to manage and do a good job with.

The large buildings we have are in markets where those are appropriate. We've stayed away from the build to suit business where you're chasing ultra large buildings relative to the market where there is only a handful of tenants or maybe even just one tenant that would take them upon availability. So I think I feel good about what we have on the high end of the range. I don't think we were exposed with anything that I would consider to be extraordinarily large in any particular market, at least nothing I can think of. And then I would probably prune a few buildings at the smaller end of the range that are flexi or just small.

Paul E. Adornato
Analyst, BMO Capital Markets (United States)
Q

Okay. And the development pipeline is as you said is almost always going to be multi-tenant in its composition?

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

Well, we may get lucky where we, Southern California we could easily divide those buildings up, Houston the building we leased up late last year or early this year could easily design to be multi-tenant but in this market we were able to get single tenant occupancy. We thought we hoped and we tried for a year or lease DCT 55 to a single tenant in Chicago. We actually thought that's where the market opportunity was when we started construction. What's ironic is that the market shifted. Vacancy for this, kind of 200,000 to 300,000 foot spaces declined pretty significantly, demand picked up and we actually saw a better opportunity to multi-tenant it after a trying for a year or so for that single tenant user. So everything we've designed has been in building is multi-tenant even if it's leased to a single tenant user on the first generation.

Paul E. Adornato
Analyst, BMO Capital Markets (United States)
Q

Okay, great. Thank you.

Operator: And the next question is from Sheila McGrath of Evercore.

Sheila K. McGrath
Analyst, Evercore Partners (Securities)
Q

Yes, good morning. Phil could you talk a little bit more about the two portfolio sales at San Antonio in Mexico, where they both portfolios widely marketed, was their lot of interest level and multiple bids?

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

Two different situations, we marketed through a broker, San Antonio and, given the age of the assets, the quality of the assets honestly in that market, it was going to be more of a, it was going to be more of a, it wasn't clear who the buyers are going to be. And the buyers we expected to be private clearly and that's who emerged. We had good interest, strong interest. And we were pleased with pricing and the execution. I mean I think CB did a great job and happy with how that went.

Mexico was a little different. As you know, you follow now Mexico and several of the FIBRAs. It was clear to me what was going down there, was it started couple years ago with the emergence of Mexican pension fund money being permitted to invest in real estate. And then the emergence of FIBRAs, I don't know two years ago or so. I was hopeful that pricing was going to move and I was pretty sure who I knew was going to buy our portfolio. We have had some informal reserve inquires over the last 12 months and we knew who to call. And so, we made those phone calls. So we marketed ourselves and distributed packages and let people respond as they saw fit – we had great response as you might imagine it's not 20 buyers down there, but it's a more than a handful.

And it wasn't just FIBRAs, it was pension funds and similar type of investors as well that expressed strong interest. In the end, we knew that the buyer of the portfolio, we knew them pretty well for some period of time and we had confidence – it really came down to confidence in their ability to execute and the amount of homework they did going into it, we were very impressed with the homework they did, the knowledge they had. I mean they really – that to me was important because didn't want to go down the road with somebody or a buyer that was learning on the job or learning as he went through due diligence I didn't want – with people involved on our end I did not want false steps, if we could avoid them. And so I was really happy with how that went. Not closed but due diligence was waived and some money is hard in we're confident as I think – as is the buyer that we will close.

Sheila K. McGrath
Analyst, Evercore Partners (Securities)
Q

And just as a follow up, was – the kind of low 8% cap rate in San Antonio and 7.7% in Mexico was that where you expected pricing to be or little better?

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

I was – well, that's a good question. San Antonio was right where we expected to be. We tried to sell these assets and actually could have sold these assets a year and a half ago maybe Matt I'm looking at Matt.

Matthew T. Murphy
Chief Financial Officer & Treasurer, DCT Industrial Trust, Inc.
A

Yes.

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

When we sold off the other assets there and there is some leasing that we're more confident and than buyers were giving us credit for, so we said lets go lease it. And so pricing is significantly better than it was at that point. Cap rates have moved some as well but leasing is what drove that. You know Mexico I sort of had in my mind kind of price in mind and we achieved it.

Sheila K. McGrath
Analyst, Evercore Partners (Securities)
Q

Okay. Thank you.

Operator: Next we have a question from Gabe Hilmoe of UBS.

Ross T. Nussbaum
Analyst, UBS Securities LLC
Q

Hi, Phil it's Ross Nussbaum here with Gabe.

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

Hi Ross.

Ross T. Nussbaum
Analyst, UBS Securities LLC
Q

How are you?

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

Good.

Ross T. Nussbaum
Analyst, UBS Securities LLC
Q

Can you talk little bit about whether or not you took a look at the Cabot portfolio if at all how hard you went after it? And maybe second talk about how you would think about the quality of that portfolio visa-visa your own assets?

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

That's a great question. As you probably know is fully marketed in 2011, I don't want to say summer or fall. We looked at them we know the Cabot people and certainly know spend a little bit of time on that portfolio from our perspective we are trying to become more focused with our assets and concentrate assets in markets that we have people in there and which we and also in which we have confidence in terms of long term market performance and in our opinion that wasn't a good of a fit for us and our strategy and our situation as we would have liked to have seen. And so we did not submit a bid back when it was formally marketing. And therefore we were not a participant in the discussions that may have been going on over the last six months that ultimately culminated with the buyer announced this week.

Ross T. Nussbaum
Analyst, UBS Securities LLC
Q

And I know you are familiar with the portfolio so if you had to stack it up against your own, how would you rate it, who is the winner?

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

Well, I like our markets a lot better. Our market concentrations are far better in my opinion, on the other hand I like, it's a good portfolio, higher quality then Cabot in the past I think, its a subjective judgmental comment but I think the quality is better and so I think I understand why others were interested in it; it wasn't something we felt was the right way to achieve our objectives for portfolio concentrations as well as, future growth prospects.

Ross T. Nussbaum
Analyst, UBS Securities LLC
Q

Okay and then if I could ask a follow up on a separate topic, you talked about the dividend for a minute, so dividend has been flat for four years now, my gut tells me if you could turn back the clock four years, you probably would have taken the dividend down another penny. So maybe if it started increasing it by this point in time, but when you sit down with the board, and you look at your earnings trajectory not just over the next couple of quarters but over the next couple of years, and you think about an appropriate pay out ratio and you think about that in context of potential rising interest rate environments and should the dividend to keep up with that. How should shareholders be thinking about how the dividend growth, now that it looks like you're covering the dividend, how that's going to match up against your earnings growth from a payout ratio context.

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

It was nice to be in a situation where we're comfortably covering the dividend and not just in our minds but in everybody else's minds. So I like to enjoy that for one moment. Given the external growth opportunities that we see and given our experience over the last five, six years with dividend that was not always comfortably covered. I think it's our bias is to wait for the dividend to get closer to the taxable minimum and that's as much art as science. So, we can't get it down to the final nubs but we need to grow, further grow into that dividend before we get into a discussion, I think about increasing it given the opportunity to deploy that capital in a way that I think is exciting from a current shareholder perspective.

Ross T. Nussbaum
Analyst, UBS Securities LLC

Q

So that may not be a 12 month event. Are we talking that could be two years out?

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

A

I will wait till we talk about guidance next year and do we even have that discussion certainly I like the future growth prospects of our business, but also know that a lot can happen over the next 12 to 24 months, so no sense trying to predict what that might be.

Ross T. Nussbaum
Analyst, UBS Securities LLC

Q

Appreciate it, thanks.

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

A

Thanks Ross.

Operator: And the next question is from Ki Bin Kim of SunTrust.

Ki Bin Kim
Analyst, SunTrust Robinson Humphrey

Q

Hey guys how you guys been?

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

A

Great.

Ki Bin Kim
Analyst, SunTrust Robinson Humphrey

Q

That's good. Just had a quick question, if you look at the incremental demand coming from e-commerce today, versus maybe three years ago, could you help to create paint that picture and given that perhaps e-commerce companies like Amazon and eBay try to move more towards quicker delivery versus tax benefits. How that impacts markets like Cincinnati, Indianapolis or even Phoenix where they might stand to lose incremental demand going forward and how that shapes your opinion on where you want be?

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

A

Let me bifurcate the answer because when people think about e-commerce they think about Amazon. Large mega dominant names so they're out there building large mega buildings. And with strategies that are easily and always followed, that's not a business that we consider something that we're particularly well suited for because you end up with buildings you wonder what's going to happen when you build a 40 foot clear 1.2 million square feet building in the secondary market in Midwest. What are you going to do with it upon re-lease, you've got to sell that building quickly and that's not our model.

The rest there's a huge number of e-commerce driven tenants. Many of whom maybe most of whom have their routes in traditional retail and they are taking space in existing stock more often than not in many different markets and we are seeing a lot of demand. So for example we just leased a building in Central Pennsylvania to One King's Lane, an e-commerce company I had never heard of but a lot of people in our company were very impressed with the name; showing my age, we leased in Cincinnati, we've done several e-commerce tenant leases. And so, as a result it's not just Amazon or same day delivery major megapolitan cities it's really these companies, Louisville has done well very well, very well in part because of transportation hubs. Cincinnati same benefit, Memphis same benefit so it's not just being next to New York, San Francisco, LA, Chicago, it is a pervasive trend across more size spectrum than you might imagine from just reading about the 10 million square foot plus build to suits for Amazon that happen in a year. Therefore it's a net benefit to honestly even secondary markets and we see as much of it in Cincinnati and others as an example so I think Cincinnati is a beneficiary not threatened by it.

Ki Bin Kim — Q
Analyst, SunTrust Robinson Humphrey

And you think that's same rationale for markets like Indianapolis and Phoenix that have been traditionally distribution focused from those big box users. You think they'll still do well going forward?

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

First of all Phoenix has been a huge home for Amazon and so we've not been a participant. We've not had much vacancy in Phoenix and what we have I can't think of a e-commerce tenant kind of in the 100,000 foot range or 200,000 foot range we just haven't had a lot of that that's not our that hasn't been our activity. So I can't speak to Phoenix below the level of that 1 million footer there has been several million footers built in Phoenix for our friends in Amazon anyway. Well there is another market, Indianapolis again we don't a lot of vacancy and Neil do you have comments on Indianapolis with respect to e-commerce?

Neil P. Doyle — A
Managing Director-Central Region, DCT Industrial Trust, Inc.

Phil only that from an e-commerce at the end of the day from a regional distribution standpoint is going to follow the same fundamentals as our typical brick and mortar. If Indi place to be to serve x number of people in x number of days well then Indi is going to win. Relative to Indi proper I think that you're e-commerce they're going to serve the demographics and whether its so for the larger regional buildings, the Amazons, whether they are in Indianapolis and Cincinnati, it may not be our game anyway. When it gets down to serving a local demographics all whom will be served one way or the other, whether it's next day, next hour or three days, I think we'll always be well positioned there as we are today in Indianapolis, Cincinnati, et cetera. It's our typical portfolio. But no major movements one way or the other in Indianapolis. We haven't benefited greatly, nor we have we seen any harm from e-commerce movement in Indianapolis.

Ki Bin Kim — Q
Analyst, SunTrust Robinson Humphrey

Okay, and thanks for that. And just for the second question, I appreciate that you guys are seeking, whether it's offside or it's value, that can be added. Can you just maybe talk a little bit about what the process is that you guys got through to force deals that possibly others aren't finding, and maybe off market is kind of an overused term, but what that really means?

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

Hey, Neil, why don't you take that one?

Neil P. Doyle
Managing Director-Central Region, DCT Industrial Trust, Inc.
A

Well, if I could, maybe I'll use 4800 Central as an example because you have all read about that or heard about that this morning. This is what you would call an off market deal. Was it broker represented? Yes. Was it a marketed fundamentally sound package? No.

And there is a situation where an owner-user is looking to cash out of real estate that has appreciated over the years, he stabilized it with his own business, he can replicate that business probably somewhere else, he doesn't need class A. The broker will entertain several people that will look at this. It's difficult to do. A redevelopment like this is going to have many challenges, physical, political, environmental, et cetera. That will often scare away a lot of the developers heavy on debt. Now you are back to, well, who can participate in an infill location who is comfortable participating in an infill location, and that seems to hurt little more. Now you are down to a couple of entities that he is comfortable dealing with. And that's when you start your pitch, and you win or you lose.

In that situation he was comfortable with our ability to close. He was comfortable with our ability to allow him the lease back that he needs to properly operate and relocate his business. We were very excited about the infill location. We are very excited about the land basis, both today let alone tomorrow when he vacates the premises in 2015 or 2016, I should say. And what we're most excited about is an absolute dearth of new product in an infill location. So we're not going to replace the square footage you see today. But what we are going to replace it with is going to be class A modern that's going to allow us better returns than we're stabilized today, thus the premise of the redevelopment as well as the opportunity to deploy more capital at a infill location with a very little competition. So it's more labor intensive from our standpoint certainly, but that's what our market teams are set up to do, and that's what Brian Roach in Chicago and his market team accomplished.

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

And I'll just add, it's a very local business, one-off hand to hand combat trying to find a deal and trying to convince a seller that our offer, our package, our valuation is the right decision to make.

Ki Bin Kim
Analyst, SunTrust Robinson Humphrey
Q

Okay. And on a go forward basis your acquisition guidance, how should we think about the split between more fully stabilized assets versus maybe deals with a little bit more hair on it?

Matthew T. Murphy
Chief Financial Officer & Treasurer, DCT Industrial Trust, Inc.
A

I think what you will see in the future is pretty similar to what we've done in the past. I mean it's difficult to predict with specificity, but we've got a pretty long track record. We've been migrating to more value add, but they come as they come.

Ki Bin Kim
Analyst, SunTrust Robinson Humphrey
Q

Okay, thank you, guys.

Matthew T. Murphy
Chief Financial Officer & Treasurer, DCT Industrial Trust, Inc.
A

Thanks Ki.

Operator: [Operator Instructions] And our next question is a follow up from Jamie Feldman of Bank of America Merrill Lynch.

Jamie C. Feldman
Analyst, Bank of America Merrill Lynch
Q

Great, thank you. Can you guys talk a little bit about leasing spreads? You had a decent quarter on the GAAP side, and they're still negative on the cash side. What are you thinking for the rest of the year? And then as you think about your expirations in 2014, do you think you're above or below market?

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

Jamie, I'll take that in parts. One of the things rents spreads-I'll sound like a broken record on this-but mix is a big part of rent spread. So we had, we were down 3.8% cash this quarter, up 3.7% on a GAAP basis, but that was driven in large part by a single large transaction in Cincinnati that was, it was a lease that was signed in 2005, 700,000 square feet, signed in 2005, and had healthy bumps. You take that out of the equation, which you can't do, but you take that out of the equation and its 10% on a GAAP basis and almost 2.5% on a cash basis. So, it's why it's such a volatile statistic.

I think the trend line is what you look at. The trend line has continued to become more favorable. No reason at all to expect that that won't continue. In fact, there's every reason in the world to expect it will as market fundamentals continue to improve across the board. So, you're never going to get me to predict a spot rent growth number because it is so difficult to predict because of mix, but the trend line is clearly positive.

With regard to 2014, we've got about 10.6 million square feet that rolls next year. So it's 17%, that's the business of industrial. I think clearly you'll see that be better than it has been for the past couple of years. I do think ultimately net-net we will be rolling up rents in 2014. I don't know the magnitude. You've got to look at the individual mix. We are not talking about 2014 guidance. But I do think the trend line continues to improve.

Jamie C. Feldman
Analyst, Bank of America Merrill Lynch
Q

Okay, great, very helpful. Thanks.

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

Thanks Jamie.

Operator: And this does conclude our question-and-answer session. I would like to turn the conference back over to Mr. Phil Hawkins for any closing remarks.

Philip L. Hawkins

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

Thanks everyone for participating. We appreciate you spending the time to follow DCT. And we are all available to answer any other questions you might have. Have a great rest of the summer as you get near the end of earnings call season. Take care.

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