DCT Industrial Trust

Second Quarter 2015 Earnings Call

Friday, July 31, 2015, 11:00 A.M. Eastern

CORPORATE PARTICIPANTS

Phil Hawkins - *Chief Executive Officer*

Matt Murphy - *Chief Financial Officer*

Bud Pharris - *Managing Director of the West Coast*

PRESENTATION

Operator

Good morning and welcome to the DCT Industrial Second Quarter 2015 Earnings Call and Webcast. All participants will be in listen-only mode. Should you need assistance, please signal a conference specialist by pressing the star (*) key followed by zero (0). After today's presentation, there will be an opportunity to ask questions. To ask a question, you may press star (*) then one (1) on a touchtone phone; to withdraw your question, please press star (*) then two (2). Please note this event is being recorded. I would now like to turn the conference over to Melissa Sachs, Vice President, Corporate Communications and Investor Relations. Please go ahead.

Melissa Sachs

Thanks, Gary. Hello, everyone, and thank you for joining DCT Industrial Trust's second quarter 2015 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 details on the quarter's results and our updated guidance. Additionally, Bud Pharris, our Managing Director of the West Coast region will be available to answer questions about our market, development and other 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 website at dctindustrial.com. And now, I will turn the call over to Phil.

Phil Hawkins

Thanks, Melissa, and good morning, everyone. We had another excellent quarter highlighted by strong leasing in both our operating and development portfolios. Market fundamentals remain very healthy with broad and deep tenant demand combined with supply that remains well in check in all of our markets. Our strong operating portfolio performance continued in the second quarter with same store NOI growth of 13.3% on a cash basis, and 9.3% on GAAP basis, ahead of our internal expectations due to better than expected occupancy and rent growth. Matt will provide more detail and color on our operating results, as well as guidance, shortly. While the lease up of our development pipeline has recently been a focus for some investors and analysts, we have always had a high level of confidence, given the assets in the markets, as well as the proposal and lease negotiation activity we were seeing. As you saw in last week's development leasing update and last night's earnings release, our confidence was warranted. Since the end of the first quarter, we have leased 2.9 million square feet in 15 different transactions, bringing our current development pipeline up to 53% leased and the total pipeline, including committed projects not yet started, to 59% leased. And just as important, leasing activity on each of our available development projects is strong. So we expect this leasing momentum to continue in the third quarter and beyond.

Our returns are higher than initial expectations, as well, given higher rents and quicker lease up. As a result of a leasing on our existing development projects, as well as pre-leasing on a few planned projects, we are raising the midpoint of our development start guidance for the year by $50 million, which Matt will discuss in more detail shortly.

As expected our acquisition volume was pretty light in the quarter, buying three assets for a total of $18.6 million. While we don't anticipate a lot of investment activity, given where asset pricing is, our market teams relationships and persistence will likely generate a few additional acquisitions this year with attractive value creation and return potential. The recent Houston Port acquisition is a good example of both our local teams' capabilities as well as the strength of a leasing market. The seller, which occupied the entire building, initially planned to downsize and relocate their operation to another to be identified building in the same port submarket. Shortly after identifying the value add acquisition opportunity, we began talking with the prospect for 50% of the building. Near the end of our due diligence period, the seller then concluded our building was the most suitable for them due to limited availability in the submarket. So we entered into a lease back for the portion of the building not yet spoken for by our other prospect. We have since then executed a lease with the new tenant, so a building, which at the beginning of our acquisition process had no lease commitments, is now fully leased with the new tenant expected to take occupancy in the third quarter. And the stabilized yield of 6.6% is at least 100 basis points, if not a 150 basis points, higher than what a buyer would now pay for the fully leased asset.

Lastly, let me give you an update on the fraud incident, which we disclosed on May 7th. This incident resulted in a second quarter loss of $3.4 million, including expenses. We do hope to recover approximately $1 million from insurance, although discussions with our carriers have not yet been finalized, so the second quarter's results do not reflect any reimbursement. Since the incident, we have investigated and confirmed there was no breach of our systems. We've also reviewed and enhanced our internal controls.

As we head into the second half of the year, I feel great about our business. Thanks to a talented team of people, high quality portfolio, strong tenant demand and disciplined new supply, my expectation is that this is a very positive confluence of factors that will lead to continued success and performance.

Let me now turn the call over to Matt, who can provide more detail on our quarterly results and updated guidance for the year.

Matt Murphy
Thanks, Phil, and good morning. From an operational perspective, I don't think it would be an exaggeration to call the second quarter of 2015 one of the strongest in DCT's history. We achieved record setting same store NOI growth, continued outperformance in rental rate growth and the development leasing that we've been describing as being on a door step has begun to turn into significant numbers of executed leases. In short, the combination of exceptional market fundamentals, our ever improving portfolio focused on infill locations in dynamic markets, and our market team's skill in maximizing leasing economics has produced results that have exceeded our already high expectations. I will go through some of the details of our second quarter numbers and discuss how these results impact our expectations and guidance for the remainder of the year.

Our operating metrics were very strong this quarter. Operating occupancy ended at 95.1%, about 30 basis points ahead of plan, as leasing activity was brisk and tenants continue to make decisions quickly and are frequently pushing to occupy space as soon as possible. Leasing stats were outstanding, as we signed 4.8 million square feet of leases, including 1.2 million square feet of new leases and 2.1 million square feet of development leases, both of which bode well for future NOI growth. Rent growth was outstanding, as well, with GAAP coming in at 14.1%. While cash rent growth was only 1% during the quarter, that number was skewed by

233,000 square foot lease we signed in Memphis to complete the lease up of our 500,000 square foot building there. In a lease structure that both accommodates the short term needs of our tenant and positions the building well for its anticipated sale next year, the lease begins with a very low introductory rate and then jumps 42% up to its normal base rent. As a result, cash rent growth on this lease was a negative 32% and that single lease decreased cash rent growth in the portfolio by 410 basis points.

Same store NOI growth was another significant bright spot for the quarter. Cash same store NOI growth was 13.3% for the second quarter, ahead of plan and the highest quarterly number in DCT's history. GAAP same store NOI growth was also very good at 9.3% for the quarter. These results were driven by average occupancy of 95.2%, an increase of 230 basis points over Q2, 2014, as well as over $1.1 million of embedded rent bumps, along with the excellent growth in rental rates I've already described. Sequential same store NOI growth was also strong in the quarter, increasing by 4.5% on a cash basis and 4.9% on a GAAP basis over the first quarter of 2015. These results were also enhanced by approximately $800,000.00 of un-forecasted onetime items, primarily damages and restoration fees paid by tenants upon move out.

Turning to guidance, our strong second quarter operating results and leasing activity were both ahead of plan, and we feel optimistic about the fundamentals for the rest of the year. Consequently, we are raising our expectations for growth in 2015 same store NOI to between 4.5% and 6% on GAAP basis, an increase of 25 basis points, and to between 6.25% and 7.75% on cash basis, an increase of 50 basis points. On the capital deployment and capital funding front, planned activity for the remainder of the year remains robust. We are increasing our guidance for development starts for the year by $50 million to be between $250 million and $350 million. This reflects the excellent leasing we've achieved thus far, as well as the leases we expect to execute in the near future. This should allow us to start several buildings that we had previously forecasted to start in 2016.

Pricing and competition for high quality assets continues to make acquisition challenging. And as a result, we are further decreasing our expectations for acquisitions for the year to between $125 million and $175 million. Any future acquisitions this year are likely to have a value add component, like the Houston transaction that Phil described earlier. Our plan is to fund this investment with the proceeds from asset sales, as well as leverage neutral incremental debt. While our guidance for dispositions in 2015 remains unchanged at $250 million to $350 million, the remaining dispositions this year are likely to be a little more backend weighted, as we believe the majority of the dispositions we're currently working on will not close until the fourth quarter.

On the capital markets front, we did not issue any stock under our ATM during the quarter. In fact, we haven't used it since October of 2014. While we are focusing on funding our activities through dispositions, we are planning to reload the ATM program during the third quarter to maintain optionality. Also, as I've mentioned previously, is our intent to access the public bond market in the second half of 2015 with the proceeds used to pay down the line, as well as some of our 2016 debt maturities. The combination of operating results and expectation described above, as well as our updated deployment and funding plan, would have resulted in an increase to FFO guidance of little over $0.03 per share at the midpoint. However, the financial impact of the fraud, net of the expected receipt of a $1 million of insurance proceeds, is anticipated to result in a net charge for the year of little over $0.025 per share. In addition, the second quarter sale of the remaining 8th and Vineyard build-to-suit and the unwinding of that venture resulted in development profits, net of the $3.7 million GAAP impacted non controlling interests, which were approximately $0.02 below forecast. Consequently as a result of netting these onetime items against positive operating results and expectations, we are narrowing our 2015 FFO guidance and lowering the midpoint by a penny per share to $1.90 to $1.98 per share. With that, I'll turn it back over to Gary for questions. Thank you.

QUESTIONS AND ANSWERS

Operator
We will now begin the question and answer session. To ask a question, you may press star (*) then one (1) on your touchtone phone. If you're using a speakerphone, please pick up your handset before pressing the keys. If at any time your question has been addressed and you would like to withdraw your question, please press star (*) then two (2). As a courtesy, we please ask that you limit yourself to one question and a single follow up. If you have further questions, you may reenter the question queue. We will pause momentarily to assemble our roster. The first question comes from Gabriel Hilmoe with Evercore ISI. Please go ahead.

Gabriel Hilmoe
Thanks. Phil, just on the development, we've seen a lot of activity in last few months and even this past week, I guess, but can you maybe frame out just what the current pipeline is looking like? I know you don't want to get into a ton of detail, but just trying to get a sense, it sounds like activity is likely going to continue kind of what, relative to what you've seen over the last months and weeks.

Phil Hawkins
We have, I'd say, a number of leases in very different markets that are out for negotiation, including even a couple that are out for signature. They just didn't get signed by yesterday, or Wednesday, I guess, when we cut it off. So that feels good. We also have pretty significant proposal activity. I'd say it pretty much, pretty much every asset we have in the development pipeline right now, without going into more detail, I'd say it's across projects, across sizes, across markets, I wouldn't flag any one market as being, or even any one project as being, falling out of that positive trend or necessarily even leading [ph] it, it's just, it feels like a good, broad pipeline right now.

Gabriel Hilmoe
Okay and then maybe for Matt, just on the expense reimbursements in the quarter. It sounds like, even if you backup that benefit, the same store NOI growth was still probably in the mid to upper 11% range and I just want to clarify, are you adjusting for that expense benefit in the back half, as well, with the change in the NOI range? Just trying to get a sense of the drivers behind the uplift in the cash same store NOI.

Matt Murphy
Right. I do think there was a little bit of benefit from an expense perspective in the second quarter and the guidance does allow for the reversal of that in the second half. I haven't done the math exactly the way you described, in terms of eliminating them, but I would say it's definitely still in double digits, were it not for the sort of onetime items and sort of timing differences. So I don't know that 11% is right, I don't know it's wrong; you've got to be in the neighborhood.

Gabriel Hilmoe
Okay, thanks, and maybe just one more quick one. Phil, there was another large portfolio that traded the last couple of days and I think, in the past, DCT may have taken a look at that portfolio, as well, but just any comments you can make just in terms of the comparability

between IIT and DCT's portfolio?

Phil Hawkins
I think it speaks, overall, to the continued demand from investors for industrial product. There is another large portfolio that, might I say, is also pending at economics that will be pretty compelling relative to public market valuations, with different investors involved than what you've seen so far with KTR and IIT, which will, I think, also demonstrate, I think, to the public, to public REIT investors the breadth of investor demand out there. I'm admittedly biased, but we do know that portfolio quite well. We also know the KTR portfolio quite well. For a lot of different reasons we compete against a lot of that, to try to buy those assets, we looked at that portfolio and, in my opinion, our overall asset quality is higher than either of the two portfolios that have traded so far.

Gabriel Hilmoe
All right, thanks, guys.

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

Brendan Maiorana
Thanks. Matt, just to follow up on the same store, so the guidance for the back half of the year implies a pretty meaningful slowdown, and just based on sort of where rents are, it feels like occupancy is going to be flat. You've got nice kind of rent gains baked in, even with the expenses going against you. Is there anything that would drive the numbers down significantly to sort of be in the low single digits in the back half the year, like move outs or anything like that, that we should be aware of?

Matt Murphy
Well, I don't think so. From an occupancy perspective, based on projecting the numbers to be flat, frankly little bit down from where we ended up. Obviously, it's a range so we could go to either side of that. So, obviously, the deceleration is a result of the back half of 2014's occupancy increasing. In fact, we averaged for that pool over 95% in the fourth quarter of 2014. So I don't think there's, there's no, I mean we have a couple, the largest move outs, we have a 215,000 in Southern California, actually, I talked about last call, they signed a short term holdover, there was some optimism they would stay, they have in fact already moved out. That's the single biggest one. But I don't, it is normal churn. So I think, ultimately, I hope we can do better than 95% occupancy in the second half. But that's with the basis of the forecast.

Brendan Maiorana
Okay, that's helpful and then maybe just as a follow up, so I think the build-to-suit that you guys announced in Atlanta, the million square footer, I think that customer is an existing DCT customer. Can you guys confirm whether or not that's the case and how you feel about the prospects and the building that they're in and back sell prospects?

Phil Hawkins
They are an existing customer. There is an extended period after they occupy the new building that they will overlap in the current building, which will give us a fair amount of time in addition to between now and the occupancy of the new building. That'll give us an additional period of time, I don't want to go into specifics, but a fair amount of time where they will essentially be paying double rent and we will have the ability to lease it. If we do lease it, however, that will relieve them of that rental obligation. The rent in place, in our view, on their existing building is

below market. So we do expect a roll up on rent and, hopefully and I would think at reasonable expectation wise, we would not expect any downtime on the building that they're leaving.

Brendan Maiorana
Okay, great, thanks, guys.

Operator
The next question comes from Eric Frankel with Green Street Advisors. Please go ahead.

Eric Frankel
Thank you. Obviously, you guys are looking to really increase your development starts over the next couple of years. I was hoping you'd comment on your return expectations for development going forward.

Phil Hawkins
Eric, well, first we've increased it for this year by another $50 million on top of what we did last quarter. I don't know if I'm looking out a couple of years with that trend, hopefully, but again, no, we're not putting something in concrete out there in terms of annualizing starts. We will take that one project at a time, one market at a time and evaluate the overall economy, tenant demand and supply, generally, as well as on a micro market basis, as we make those decisions. We continue to look at returns that are plus or minus, on a spec basis, 150 basis points higher than what we believe is a somewhat conservative expectation of a stabilized cap rate if we were to sell the asset or what investors and analysts will ascribe because of NAV, once stabilized. So we're looking to create meaningful value, some period before that up to a margin, a meaningful margin, where we take speculative risks. On a build-to-suit basis, same thought process applies, including it needs to be a building that we believe is a market building, not a special use building. And in these weird economics that create value, although given the less risk of leasing, we will take less of a margin. Yeah, I think that's, I can address a follow up if didn't quite hit the question, the answer you're looking for.

Eric Frankel
That's acceptable, thank you. I was hoping, similar to Brendan's question about the Atlanta build-to-suit, you can comment on the lease mechanics of the Carol Stream build-to-suit outside of Chicago.

Phil Hawkins
Yeah, they are an existing tenant, as well, much, they're, I would say to size, about third of the total and there is no similar mechanism in that. We will have the lead time of construction and move in to prepare and we're currently leasing that space now, but they will be leaving that building upon occupancy of the new building.

Eric Frankel
And what's the current size, roughly, of the tenant's space now?

Matt Murphy
I think it is 105, Eric. It is right around 100.

Eric Frankel
Okay, much meaningfully smaller. Okay, sounds great.

Phil Hawkins
Yeah, not nearly as meaningful as the one in Atlanta. They're coming out of several other buildings, as well. Not ours and so it is a consolidation of several facilities, unlike Atlanta, which is just pure growth.

Eric Frankel
Very helpful, thank you.

Operator
The next question comes from Juan Sanabria with Bank of America. Please go ahead.

Juan Sanabria
Hi, I was just hoping you could expand a little bit more on supply to start, you sort of said that you view all markets in an equal balance, but is there anything in particular, any markets that are concerning in the near term or as you look out maybe 12 to 18 months, any thoughts maybe on Houston, in particular, given the recent decline in oil prices we've seen?

Phil Hawkins
I hope I'll get all those sub questions. First, no, not a market that I identify with concern. The last couple of quarters we would have picked on Dallas, maybe Houston and maybe the Inland Empire. I would say Dallas construction has come down, demand has gone up and you're seeing, therefore, different dynamics. Houston, I am pleased, impressed, maybe little surprised at how well that market has held up from demand perspective. Construction, I think, is responding, it'll come down if demand comes down. Some of the construction is going on in the Port market, where, actually, demand is shifted toward as we, as evidenced by the acquisition and re-lease up of the building I talked about in my earlier remarks. Inland Empire, and I'm going to let Bud actually comment on that, is probably the market with most construction. Inland Empire West is much more in balance, which is where we are, both our current assets as well as our development in land. Inland Empire East, construction has picked up. I guess if I was going to pick on one area as something to watch, it would be Inland Empire East; but, boy, demand has been really healthy there, as well.

Before I turn it over to Bud, my comment about, outlook over next 12 to 18 months, all I can tell you is the same dynamics, the same factors that I've been talking about now for probably two years, that increased discipline this time versus last time, I believe are still in effect and still apply and will likely lead to continued discipline. I can't assure you of that for the next 18 months, I am not fortune teller or future teller, but I continue to believe that that will be the case. There will no doubt be anomalies as some supply kicks up, as multiple developers all chase the same goal or demand ticks down in a particular market, I'm sure it will not be perfect or flawless but I still feel pretty optimistic. My view is what to worry about in industrial is not demand, not as much, it is the worry about, I mean, not to worry about supply. Supply is easy to turn on, as we've proven; it's also easy to turn off. It's demand and from what we see and what I see in terms of the economy, I believe demand is going to remain about where it is now, healthy, broad amongst sizes of the tenants, industry types. We even saw pick up in some housing related transactions in the second quarter, as well as now in the first month of the third quarter, so even that is a positive. So I feel good but I also recognize that this is an uncertain world and uncertain business and that's why they call it risk, but I am pretty confident, pretty optimistic. Bud, do you want to comment on the Inland Empire?

Bud Pharris
Sure, thanks, Phil. I think what's interesting to point out is when looking at supply and it's

something we think about and we watch carefully, but you also have to talk about demand, as Phil had stated, and demand has been very strong and remains so throughout Southern California and the Inland Empire, in particular. We've seen really strong positive net absorption numbers, year-to-date, on track to be by far the strongest year ever dating back 2000. So that feels good and, generally speaking, looking at the numbers, there was about 14 million square feet of construction underway in the East that's about 20% leased and, conversely, in West, which is a little bit of the tale of two cities, there is 10 million square feet that's 45% pre-leased and so that absorption that strength is something we're seeing on continuing. We also track very actively users in the market, we've watched this list quarter by quarter, year-over-year, and right now we've got a list that has about 34 active users looking for 23 to 26 million square feet in a range and these are people that will transact in the next 0 to 12 months. A lot of eminent deals, as well, going on, so we feel really good about the demand, feel good about the fundamentals and very strong in the Inland Empire.

Juan Sanabria
Great, thank you.

Operator
The next question comes from Manny Korchman with Citi. Please go ahead.

Manny Korchman
Good morning, guys. Matt, on the planned bond issuance, could you share sort of sort your idea on potential size, where pricing might be, and how you're thinking about timing given that you're thinking about paying off debt in the next year with it?

Matt Murphy
Yeah, so I think, clearly, it makes sense for us as a relatively new issuer in the market; it's got to be index eligible, which means it's going to be a $250 million deal or more. I think $250 million is, I know, the way I am thinking about it today. I also think, given liquidity in the market as well as our own maturity schedule, that's it's extremely likely to be a 10 year deal. And I think, based on preliminary bank, or conversations I've been having with bankers and when you are still, more than 30 to 60 days out, it's, obviously, all comes with caveat, but I would say pricing somewhere in the 200 over treasury, so between 175 and 250 over is a reasonable starting point. Obviously, those numbers get more, Hawkins is giving me a dirty look because I'm putting such a wide range out there, but I think that's reasonable, given what the market runs [ph], if we are going to do it today. It'd probably be 200 over, if we are going to do it today.

Manny Korchman
Great, that was it for me, thank you.

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

Craig Mailman
Hey, guys. Phil, your comments on supply were helpful here, just I guess as a follow on to that, how is that affecting what you guys are thinking about for rent growth, because supply has been disciplined but it has been steady in most markets and just the trajectory of asking rents in most markets?

Phil Hawkins
I think two phases of rent growth. The first phase is the market recovers and you're obviously

seeing a significant imbalance between supply and demand and rent growth that in many markets it has been high single digit, low double digit. In most markets now, we're passed that phase and there maybe are one or two left and Atlanta's been one of the more recent examples where late to recover, but boy, it's recovered very well. Now we're seeing rent growth because we have vacancy rates that remain, in most markets, mid single digit. Demand that's really healthy and so you've got multiple choices as an owner or a developer. And you've got rent, cost inflation coming in the form of land prices that are going up, as well as construction costs that are going up 3% to 5% a year, which gives you, I think, an environment where you can achieve mid single digit rent growth in many, if not most or all, markets. Just because you have supply at current level does not mean it dilutes rent growth. In fact, I think it helps maintain a market that is somewhat in balance. In fact, the more supply can remain at current levels, you don't create huge imbalances of supply and demand, you're not going to get a big reaction, overreaction, of new supply coming in trying to chase a incredibly tight opportunity. So I think we're in a pretty good situation right now from a rent growth perspective, as well as supply and demand and current vacancy.

Craig Mailman
That's helpful. I guess I was just thinking about, too, is people are just accepting lower returns, so even though costs are going up, the lower return thresholds, I don't know if that would have kept a cap on rent growth and, net/net, they would could have offset each other.

Phil Hawkins
Well, you're correct. Returns have come down, but also, as perceived risk has come down and land costs have gone up, land costs have gone up much faster than single digit rent growth would imply and so lower returns have offset that somewhat. I think we're now in an environment, given where interest rates are and given that some of the competition is looking at development with a levered basis, maybe with a guarantee, but they're looking at leverage, and/or on the take-out, but as interest rates have flattened and come back up, I think cap rates are flattening. And, with cap rates flattening, that will also have an impact, I believe, on further compression and development yields. At least, that's my hope. Who knows how the world actually unfolds, but anyway.

Craig Mailman
Then just bigger picture, relative to the private market trades out there in the market, we know about KTR and IT, and you alluded to another portfolio, you and the broader industrial group continue to trade at a wide spread, relative. Just as I am thinking about kind of ways to narrow that gap or exploit the gap, is asset sales, which you guys have done but is there any thoughts about really being more opportunistic about selling assets that potentially you could sell for in excess of what The Street is kind of modeling in for any V purposes and kind of your thoughts on doing that and your views on potentially special dividending?

Phil Hawkins
Who knows where valuation for a large portfolio may ever come in? I think from an individual asset basis, I think The Street isn't too far off with respect to individual asset pricing. It's a pretty transparent world out there and many investors and all analysts have a relationship with at least if not multiple investment sales brokers. You're certainly hearing from our, you see trades that we make. I think the real question is there a portfolio premium and what is that for any particular portfolio, whether you're public or private. I don't think individual assets sales address that. In my mind, we sell assets when we believe pricing and current returns, NOI growth, and long term returns in the form of an IRR feel less compelling to alternatives to deploy that capital. Certainly, where we're deploying that capital right now is in development. I can also tell you that

we look at the Board level, as well as amongst the management team, at stock buyback and evaluate that as an alternative. We have not decided to execute on that but we certainly consider it and think about that as a use of capital as we look at other alternatives to deploy that capital, as well as the cost of sourcing capital through asset sales. None of that is a science but we're mindful of all of it and trying to be the best stewards we possibly can be with the existing capital we've been entrusted with, as well as the opportunities to recycle and redeploy that capital in the way we think is best suited to maximize value over the intermediate and longer term.

Craig Mailman
Great, thanks.

Operator
The next question comes from Erin Aslakson with Stifel. Please go ahead.

Erin Aslakson
Hey, good morning out there. Just one question was how sustainable do you think the mark-to-market on rent rollovers are as you kind of pull forward on the vintage, going into next year?

Matt Murphy
Yeah, Erin. It's Matt. Honestly, I think, if you look at, if you evaluate the leases that are rolling over the next, say, 18 months, I'm sure, as you've heard, one of our competitors addressed it that way, kind of looking at the comparison of what has the vintage of what leases we have signed versus the future, it actually bodes pretty well. If you look at the leasing that we've done on the first half of the year, 26%, or little more than 26% of that was done during the trough and I'll agree with their characterization, the trough is sort of 2009 through the end of 2011, whereas, for the next 18 months, a little over 40% of our leases were signed during that same trough. Now it is not, that doesn't guarantee anything. There is a lot more going on than just when was the prior lease signed. But to me, that sort of indicates that the favorable environment from that particular statistic is not yet done, by any means. So as I will continue to never predict any particular quarter because of the nature of that calculation and the volatility of the mix, I still think there are some legs on that. And I think if you look at it from a vintage, which is one way of looking at it, I think those stats certainly bear that out.

Erin Aslakson
Okay, that's great, thank you.

Phil Hawkins
Good question, thanks.

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

Mitch Germain
Nice quarter, guys. Matt, I missed your commentary on the changes of guidance, so if you could just do me a favor, I'd really appreciate it.

Matt Murphy
Yeah, I mean, ultimately, what it comes down to is, but for the onetime charges, guidance would have gone up by $0.03 at the midpoint.

Mitch Germain
Gotcha and the charges, the charges were?

Matt Murphy
Oh, I'm sorry, yeah, so the charges are really the net GAAP impact of the sale of 8th and Vineyard, which ultimately ended up being as a $1 million debit and the fraud, which was $3.4 million in the second quarter and we're anticipating a $1 million insurance proceed, so ultimately, it's $2.4 million for the year, which translates at our current share count into $0.026 a share, so it's really $0.035 of onetime items and we're lowering guidance by one point, or $0.01 at the middle.

Mitch Germain
Gotcha, so an effective raise. And then, it seems like most of the proceeds that you're raising from the debt offering are just going to be utilized to term out some maturing debt. I'm just trying to think about the capital plan as you move into 2016.

Matt Murphy
Yeah, so first of all, yes, the bond deal will effectively be a refinancing of a number of things, ultimately, it ends up paying down the line, so that will not be incremental debt, certainly not in any meaningful way, probably not at all. And the capital plan, I'm not going to get into '16 in depth, but ultimately, right now I think the best cost of new capital for us is selling assets. We'll continue and, as I've said before, to capitalize our deployment plan in a way that it is leverage neutral, we've worked to get to a place where we feel like our balance sheet is in pretty good shape. I think of leverage today not so much as liabilities divided by current value of assets, but more on a debt to EBITDA basis. And so what we'll do, assuming all of the various pieces of the capital stack market stay where they are today, is fund deployment, which we now believe will be development, predominantly, with dispositions in an amount and at a rate that allows us to maintain leverage.

Mitch Germain
Thank you.

Operator
The next question comes from Ki Bin Kim with SunTrust Robinson Humphrey. Please go ahead.

Ki Bin Kim
Thanks, just a couple maintenance questions here. So going back to your comments about lease spreads, if you could kind of wrap that up for us, it sounds like you think the 14% lease spreads that you signed in the first half on the GAAP basis, as we go into next year and so could get better based on the vintages. Is that a correct conclusion?

Matt Murphy
Yeah, that's what, the way I would put it, and that's one way to interpret it. The way I would put it is I see nothing systemic that would put a damper in the near future on where rent growths, nothing that is a result of a change in a comparison that should change the outlook for the next 18 months. The lease, the rent growth stat is so volatile as it relates to mix, that I don't want to predict a number. What I have been describing is an environment where I don't think the party is over. Whether I think they're going to go up, down or sideways, it depends on your view of what you think market rents are going to do, et cetera. So I can understand that conclusion. I

don't know that I'm willing to say that yet, but I don't know what's going to change in the short term.

Ki Bin Kim
Okay, I mean, that's helpful, and I know you were talking about the same store NOI in the build up and how the expense number could be little bit in flux or vague, but do you have what that would look like or the detriment that would be in the third quarter or so? Obviously, you had little bit of a favorable comp in the second quarter, how much of that doesn't make an impact in the third quarter, going to other way?

Matt Murphy
Contrary to what it may seem like when you're running models, it's hard to predict expenses. I think what you can see is that you can do math on where we are in the first half of the year versus the second half. I don't think the giving back the positive expense variance that we experience in the second quarter is going to have meaningful impact. I was asked if we will give some of that back and my forecast predicts that we will. But we're talking about hundreds of thousands of dollars, not millions. And one thing you always have to keep in mind, again, it's not as simple and clean as it is on a theoretical basis. Most of expense variances get compensated for; our tenants pay 85% to 90% of our expenses. So ultimately, savings and expenses are muted by reductions in recoveries and the reversal of any savings will be similarly muted.

Ki Bin Kim
Okay, and just last one, you guys have really transformed your portfolio since, I guess since your IPO days. Any sense of where you think a reasonable peak occupancy would be for your portfolio today? Or not today, going forward?

Phil Hawkins
Well, yeah, I think you can, I think it's up to around modeling at 95%. Not to speak ill or try to be positive, I think we've got enough turnover, downtime, rebuilding of tenant improvements for new tenants, 95% is not a bad number. Now I think it's quite possible that we will hit 96% or 97%. Some of our peers have already done that. I also think that, if we continue to find a couple of value add opportunities, that we will sell, we will continue to sell full and buy empty, although it looks like it'd be less meaningful to the, at least the buying empty part over the next six months, given where pricing is for everything. But to me, I don't want to promise sustainable occupancy above 95%, I hope for the better. We certainly will push for better. And as we get better, we probably will start selling some of those assets, too, but we'll, I don't want to promise, I don't want to overpromise above 95%.

Ki Bin Kim
Okay, thank you, guys.

Operator
The next question comes from Paul Roantree with JPMorgan. Please go ahead.

Paul Roantree
Hey, guys, just a quick question on the development pipeline. You disclosed in the sup about 100 plus million of pre-lease developments that haven't started yet. I was just wondering, are you guys ramping up on the build-to-suits compared to spec?

Phil Hawkins
Ramping up implies kind of a strategic, something that's changed in our outlook. The answer is no. We try to be opportunistic in each of our markets and would love to pre-lease great buildings, if we can and certainly, the land we've had, we have is terrific. But I think it's a result of market opportunities that come our way as opposed to any shift in tactics. It's not like we can control that.

Matt Murphy
The only thing I'd add, Paul, is that don't confuse build-to-suits and pre-leased. So, build-to-suit is a building that's built because of the lease, as opposed to the pre-leased that is a spec building that gets leased before it starts. So what you're seeing, a lot of what we're doing, they are leased buildings in pre development but they're not build-to-suits. The 240,000 square foot in Seattle is a perfect example. We were going to build that building anyway. We are thrilled to have a tenant already signed up before we start. So it's not like we are in the build-to-suit business. We will do that as opportunities warrant, as Phil said, but most of what you see that is pre-leasing is, in fact that, it's the pre-leasing of spec development.

Paul Roantree
Got it, thanks, guys.

Matt Murphy
Thank you.

Operator
The next question comes from Tom Lesnick with Capital One Securities. Please go ahead

Tom Lesnick
Hey, good morning, guys. Just looking at your lease expiration schedule by market for 2016 and 2017, on a percentage basis, it looks like in the Memphis and Orlando are little higher than the other markets. Just wondering how you guys are thinking about retention in those markets over the next couple of years and how that shifts at all your thinking about market allocation.

Matt Murphy
Well, clearly, as I look at it, I haven't done a whole lot of studying beyond '16, to be honest with you, in terms of what spaces are rolling. I think the markets that where we have exposure, and particularly in some cases like in Southern California, the size ranges that we have, Southern California is our biggest exposure, I call it exposure, biggest roll next year. I like where the specific, the buildings, the spaces that are leasing. We've got some big spaces rolling in Southern California, which is in some ways a little bit scary, but in some ways that's exactly where the market is today. It's hard for me to predict retention that's significantly different than kind of the historical norm, which is going to be kind of mid 60s. In some ways, retention is then harmed by the current environment because companies are growing and we have our portfolios and buildings are so full, if you need another 50,000 square feet in a building that's full, you're not going to keep that tenant. The flip side is tenants that are staying the same size don't really have a lot of attractive options. They're really unlikely to find a better deal somewhere else. And, quite honestly, for most of our tenants, moving is the pain in butt, it is pain for us, too, it is an expensive and logistically challenging measure. So you got two sort of things that are working against one another. But at the end of the day, it's an individual decision on an individual tenant basis and so I don't see any reason why kind of historical trends should be any different, where you're going to see sort of maybe low 60s to mid 70s kind of retention. And I don't see any reason to divert from that.

Tom Lesnick
Great and then shifting to construction costs for a second, obviously, there is multiple components, but just looking at the labor market, are you guys seeing any trends higher in certain markets than others right now?

Phil Hawkins
Bud, you want to take that?

Bud Pharris
Sure. Our construction costs, as Phil has mentioned earlier, 3% to 5% is pretty spot on. California, in particular, and the West Coast as it relates to some of the products that are used, wood in particular is, wood and roof structures are something that we're seeing as material price increases. The kind of the good news to that, too, is that the roof structures are also, or wood is also used on the residential side. We see some other price volatility that's more volatile in concrete and steel and those kind of back off, but at the end of the day, I think that the real driver on some of these things is, being in a state of California with our energy code and water quality requirements, they cause issue for us as it relates to increased requirements for development and things along that line. But generally speaking, we are seeing that 3% or 5% is pretty spot on. Some of the general contractors are staying within their typical profit margins, but it's the subcontractors and the material suppliers that are sticking to their numbers a little bit higher because they can and they have a lot of other opportunities. So that's kind of what we're seeing some of those increases, as well.

Tom Lesnick
Got it, and then just kind of a bigger picture question, what are your thoughts on doing another development JVs similar to 8th and Vineyard, going forward?

Phil Hawkins
The reason we've done development JVs, and we have one in Broward County in Florida, as another example of where we're in the process of actually developing the land before we started going vertical, is to acquire land. And if we can acquire land on our own, we prefer that. If the seller of that land wants to stay into the asset, we will consider that as long as we have complete control. And each of the JVs we've done over the last couple of years, there haven't been many but there have been several, have involved DCT having complete control with respect to starts in leasing and other decisions. It is not share, typical JVs have shared control and we just don't feel that we wanted to be in a situation where we are dependent on somebody else to make good decisions on our behalf.

Tom Lesnick
Got it, nice quarter, guys. Thanks, that's all I've got.

Phil Hawkins
Thank you.

But Pharris
Thanks, Tom.

Operator
Again, if you have a question, please press star (*) then one (1). The next question is a follow

up from Eric Frankel with Green Street Advisors. Please go ahead.

Eric Frankel
Thank you, just a few quick follow up questions. One, could you, maybe, go into little more detail on the leasing process for DCT White River?

Phil Hawkins
The leasing process or leasing activity?

Eric Frankel
Yeah, the leasing progress, I should say, not process, sorry.

Phil Hawkins
Hey, Bud, it's your, go ahead.

Bud Pharris
Yeah, so we've got, Eric, as you may have seen in our release, we've got 215,000 square feet leased and we have very active, very active progress on the balance of the building. We've got a couple of tenants that we're speaking with right now, one in lease negotiations and another two tenants looking at the last remaining space. So the activity has been really strong. We've talked about that for the last 60 days, internally, and in the last couple weeks, as you have seen, we've done, we've had some great progress. We feel really good about our position there and hope to transact here very shortly.

Phil Hawkins
The only thing I would add, in general, Eric, and you've probably heard the same thing, while demand is up across all markets, Seattle really seems to have caught fire. Not that it was necessarily ice cold, three months, six months ago, but I've talked to two of my peers that are developing there or own buildings there, they've had a similar experience or observation. For whatever reason, Seattle tenants are on the prowl and we're happy to help them find a home.

Eric Frankel
I appreciate the additional color. Bud, actually I had to ask couple of follow up questions for you. I think your reference, perhaps, with water rights issues in California, the entitlement process, and obviously, you've built yourself a couple of buildings during the cycle, can you comment on the entitlement process or how or if it's changed during this cycle relative to the past several years?

Bud Pharris
Yeah, I think most importantly to point out, Eric, as you probably know, is the entitlement process in California is not an easy one. We've had certainly, as I referenced, the energy code and some of the water quality requirements. Greenhouse gases and clean air initiatives are very important. Age of equipment, as it relates to getting under construction, is also something that is creating more pressure on the construction process, but from the entitlement standpoint, it really hasn't changed a whole lot in most instances, actually in all instances we're following the CEQA standards related to getting a project approved in the jurisdictions. I've been doing it for a long time, we have many of our team members here have been doing this for long time and understand the process, but it's not like other parts of the country where you can be under construction in a short period of time. Some of these entitlement can take anywhere from 12 to 18 months. But it's a process we know well and continue to work with our jurisdictional

approvals here and it's not necessarily direct science, it's a little bit of art, too, so but we feel really comfortable in that process.

Eric Frankel
Okay, and finally, you referenced the really high numbers of construction starts in the Inland Empire. Could you maybe go into a little more detail on SBLA and if there's any progress that could be made in taking advantage of the options you have in place to do build-to-suits or spec development, if it calls for it?

Bud Pharris
Yeah, that is something we're looking at, a lot of opportunity as it comes from the Inland Empire West and East, oftentimes and most of the time, we're seeing the same proposals in the high desert. So the willingness to look at that market is something we see in the tenants, we're talking to them about our opportunities not just for basic space, but also the manufacturing infrastructure and things along that line. So we are talking to some tenants. We've had a fair amount of activity, but I think for just the straight bulk distribution user, that's a tougher proposition in the high desert but there is still, like I said, quite a bit of interest in the site as it relates to manufacturing, assembly and things along that line.

Eric Frankel
Interesting color, thank you very much, appreciate it.

Operator
This concludes the question and answer session. I would now like to turn the conference back over to Phil Hawkins for any closing remarks.

CONCLUSION

Phil Hawkins
Well, thank you, everyone, for joining our call today. We had an excellent second quarter and expect that favorable tenant demand and disciplined new supply will maintain an environment in which DCT can continue to deliver strong results for the year and beyond. With that, enjoy the rest of your summer and we'll talk soon.

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