DCT Industrial Trust Inc.

First Quarter 2016 Earnings Call

May 6, 2016 at 11:00 a.m. Eastern

CORPORATE PARTICIPANTS

Melissa Sachs – *Vice President, Corporate Communications and Investor Relations*

Phil Hawkins – *President & Chief Executive Officer*

Matt Murphy – *Chief Financial Officer*

Bud Pharris – *Managing Director, West Region*

PRESENTATION

Operator
Good morning, and welcome to the DCT Industrial Trust First Quarter 2016 Earnings Conference Call. All participants will be in listen-only mode. Should you need assistance, please signal a conference specialist by pressing the star key followed by zero. After today's presentation, there will be an opportunity to ask questions. To ask a question, you may press star then one on your touch tone phone. To withdraw your question, please press star then two. 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, Amy. Hello, everyone, and thank you for joining DCT Industrial Trust's First Quarter 2016 Earnings Call. Today's call will be led by Phil Hawkins, our President and Chief Executive Officer; and Matt Murphy, our Chief Financial Officer, who will provide details on the quarter's results and our updated guidance. Additionally, Bud Pharris, our Managing Director of the West Region will be available to answer questions about the markets, development, and our real estate activities.

Before I turn the call over to Phil, I would like to remind everyone that management's remarks on today's call will include forward-looking statements within the meaning of federal securities laws. This includes, without limitation, statements regarding projections, plans, or future expectations. Actual results may differ materially from those described in the forward-looking statements, and will be affected by a variety of risks, including those set forth in the earnings release and our Form 10-K filed 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. The first quarter was a strong start to 2016, as customer demand remains robust while new supply remains well in check. Better than expected operating results, including occupancy, rent growth, and same-story NOI, led us to increase operating and financial guidance for the year, as we remain confident in our business and market fundamentals.

Despite significant volatility in the capital markets related in part to economic uncertainty, our customers' behavior has not wavered. They continue to make decisions promptly, and their need for more and better distribution space remains unabated. While e-commerce has been a clear tailwind for our sector and DCT, customer demand is active across all industry verticals and size ranges.

On the subject of e-commerce, I like how DCT is positioned with our high-quality infill-focused portfolio. Following a very active e-commerce year in 2015, we recently signed two full-building leases totaling just under 500,000 square feet in California. One with a leading e-tailer near the L.A. airport, and the other with a leading package delivery and logistics company in a building we are completely redeveloping in Hayward, a submarket in the East Bay of Northern California. We also have a third significant lease pending with the leading e-tailer in an infill location in Atlanta.

Leasing in the second quarter has gotten off to a strong start as well, with 2.2 million square feet signed in our operating portfolio since the end of March, 700,000 square feet from new leases, and 1.5 million square feet from renewals, further reinforcing our confidence for the year. Reflecting the favorable market environment, our development and redevelopment business continues to perform very well. During the quarter we stabilized seven buildings totaling 2.4 million square feet with a projected cost of $167 million, and a yield of 8%. We estimate that we have created $63 million of value from these projects, a 38% margin based on Class A cap rates for each market as estimated by CBRE.

We also started three new development projects totaling 780,000 square feet since January 1st. And most importantly, leasing of our development and redevelopment pipeline continues to exceed expectations with 900,000 square feet of leases signed so far this year. Our current development pipeline of 4.2 million square feet is 63% leased. A very healthy number, especially considering the 2.4 million square feet of 100% leased development projects that were placed into the operating pool during the quarter.

Our building in Hayward that I previously mentioned is an excellent example of our approach to creating value. We acquired this building in 2015 with a redevelopment plan to shrink its size by 25% in order to create a large truck court with generous trailer parking; features that didn't exist previously and are critical to modern distribution needs including those of e-commerce related tenants such as the one we just signed. We are also increasing the floor slab thickness to increase weight load capacity and adding ESFR sprinklers. All this, in combination with clear height in excess of 28 feet, will result in a highly functional, Class A distribution building in a heavily land constrained infill market with virtually no vacancy. While we have only just finished the demolition phase of this project, our vision for the asset was confirmed by the recent full building pre-lease that I mentioned earlier. The tenant will move in October 1, right after all the improvements are completed. A great job by our Northern California team.

In addition to this project, we have recently completed a number of successful redevelopments in Chicago and Dallas, among other markets, and we will continue to look for similar opportunities to redevelop buildings in strong infill submarkets.

Before turning the call over to Matt, I do want to acknowledge Tom Wattles substantial contributions to DCT as Board Chairman since the Company's founding. Tom has decided to retire from our board, but I'm pleased that he will remain involved with the company as Chairman Emeritus, serving on management's Executive and Investment committees. I also look forward to continue working with Tom August, who assumes the role of Board Chair. Many of you know Tom August, and no doubt would agree that we're fortunate to have him as a board member and now as our Board Chair.

With that, let me now turn the call over to Matt who can provide more detail on our first quarter results, and our outlook for the balance of the year. Matt?

Matt Murphy
Thanks, Phil, and good morning, everyone. Our first quarter was very positive at DCT, both financially and operationally. Almost every metric was ahead of plan as rents and tenant demand continue to surpass our already optimistic expectations. I'll walk through some of the details of the quarter and talk about their impact on our full year 2016 guidance.

FFO for the first quarter of 2016 was $0.54 a share, which was roughly $0.02 ahead of our internal projections, driven by a number of factors, including better than expected occupancy as well as a couple of un-budgeted one-time items. Consolidated operating occupancy was 95.8% at March 31st, which was considerably higher than expectations. This favorable outcome was driven in large part by a 400,000 square foot tenant in Atlanta unexpectedly staying in their space through the end of March, as well as two wins leasing up space early in Atlanta and Southern California, totaling almost another 400,000 square feet. The delayed move out is, frankly, just good fortune in a building we acquired in 2015 knowing that the tenant would vacate. However, the two leasing wins are just the latest example of how quickly tenants are willing to move to lock up space in tight infill locations. Neither of these now existing tenants were even serious prospects only three months ago.

In addition to the excellent operating results, our numbers also benefitted from two one-time items. First, we received a settlement of approximately $500,000 from a manufacturer related to a roofing product liability claim. The cost to repair those roofs was incurred and reflected in 2015.

Second, we received a payment of a little under $1 million for a restoration fee from a tenant who we released early from their lease. Concurrently with their release, we signed a new tenant to backfill the 100,000-square-foot space once the improvements are completed. The way the accounting works, is that the restoration fee is included in NOI, and the improvements will be reflected as turnover cost, which is one reason you see somewhat elevated turnover costs in our leasing stats this quarter.

Turning to capital markets, we raised a net $48.6 million under our ATM program, issuing 1.2 million shares at a weighted average price of $39.93 per share. We issued the vast majority of these shares in early April, as we took advantage of the enhanced liquidity during the window just prior to our inclusion in the S&P Midcap 400 Index. Given the price and our stated desire to further drive down leverage, we decided it was an excellent opportunity to raise capital to fund our development pipeline, as well as de-lever in the most efficient manner possible. This is the first equity we have issued since 2014, and we do not have additional equity issuance included in our capital plan for 2016.

On to guidance, we have increased our 2016 guidance for FFO as adjusted to $2.10, to $2.20 per share, up $0.03 per share on each end. This increase is attributable to the items I discussed earlier, as well as a modestly improved forecast for leasing for the remainder of the year. These factors have also led us to increase same-store guidance for the year to between 4% and 5% on both a GAAP and cash basis, up from between 3.6% and 4.6%. Also, our improved leasing experience and outlook has led us to increase our expectations for 2016 average occupancy in our operating portfolio to between 94.75% and 95.75%. Due to the equity issuance I described, we are lowering our disposition guidance to between $100 million and $150 million. Given the combination of equity and dispositions in our plan, we expect that our debt to EBITDA ratio will be at or below six times by the end of the year, while comfortably funding our development pipeline.

Finally, we are increasing our guidance for development starts to between $175 million and $275 million, all of which can be achieved on land we currently own or control. As a reminder, for further details about the elements and assumptions inherent in our guidance, please refer to page 18 in our supplemental reporting package.

In summary, the first quarter was a very encouraging beginning to the year. We had a few operational wins, and the fundamentals in our business remain in excellent shape. We continue to incrementally improve our credit metrics, and our balance sheet will provide us with tremendous flexibility to execute our strategic plan. Perhaps most importantly, our high quality, infill-oriented portfolio appears very well positioned to benefit from e-commerce and other logistics tailwinds in our business. 2016 is shaping up to be another very successful year at DCT.

With that, let me turn it back over to Amy for questions. Thank you.

QUESTIONS AND ANSWERS

Operator
At this time, if you would like to ask a question, you may press star then one on your touchtone phone.

If you are using a speakerphone, please pick up your handset before pressing the keys. To withdraw your question, please press the star then two. Please limit yourself to one question and one follow up. If you have further questions, you may re-enter the question queue.

Our first question is from John Guinee at Stifel.

John Guinee
Great, great. Nicely done, gentlemen. Quick question for you. On land, you're down to, basically, a couple different projects in Miami, 40 acres in Northern California, a relatively modest 12 acres in Orlando, 13 acres in Seattle. Do you expect that to continue to shrink, or do you expect to ramp up in your land inventory?

Phil Hawkins
I think we'll continue the process, which is replenish as we go. In almost every one of those markets that you mentioned, we have land sites that we're working on right now under contract or maybe just shy of that. Looking at entitlements, environmental approvals, we're typically looking at projects where we're assembling land or taking it through re-entitlement. The project in one of the markets you just mentioned, the market believed there to be wetlands on there, and we believed there wasn't, and we just confirmed that we were right. As an example, we're just trying to create value through the land process. Very difficult right now for us to buy land in auction processes; land that's already entitled, ready to go. That's just not our game. But we'll continue to replenish with an eye towards staying on offense, but without getting too heavy on a land bank, which we know where that eventually ends.

John Guinee
Okay, so if I'm just looking at this quickly, you have projects under in process in Dallas, Chicago, D.C., Atlanta, and Southern California, but no land in inventory. Will you expect to continue to develop in those markets, or is there any of those markets that you think are pretty over done?

Phil Hawkins
None of them that are overdone from a supply and demand perspective. Like each of the ones you mentioned, our focus is really can we find a land site at the right price, in the right location, which accommodates a building in a site plan that we believe is state-of-the-art, and not talk ourselves into lesser quality locations, or lesser quality site plans, or frankly, lesser quality financial returns. I'd say a number of the sites we're working on are in those markets, either redevelopment or straight up land, but in some cases we'll be knocking down buildings or redeveloping buildings. None of what we're working on is clearly yet reflected on the balance sheet because it's not closed or done. But we got a pretty good - I'd say we have a pretty active pipeline of ideas. When you're working on that kind of project, John, as you know, you're not always successful. We've got great hopes. We've got every reason to be optimistic about each of the things we're working on, but we've got a lot of work to do.

John Guinee
Great. Thank you.

Operator
The next question is from Manny Korchman at Citi.

Manny Korchman
Good Morning, everyone. Maybe given the peak occupancies in the portfolio and good trends throughout, how do you think about rental rate growth versus occupancy, or giving up one versus the other in today's environment?

Phil Hawkins
We're in favor of both, clearly, but I think in this environment, we've been focused on it actually for more than a year, this is an opportunity to push rents and rent bumps, and other lease terms. Occupancy is going to happen. We've got significant tailwinds in our business that I'm very grateful for and the question is how do we leverage that without over-leveraging. Obviously, we're not trying to be too crazy here, but I think right now in most markets, most buildings we have, we're very mindful of the unique opportunity we have to push rents, achieve good rent growth, maybe even lead the market and encourage the rest of the market to push rents. Our teams on the ground are thinking about that all the time. Again, without being overly arrogant about it, we're in a very good business, and we continue to enjoy that luxury.

Manny Korchman
Great, thanks. And then, Matt, are there any other one-time items hanging out there similar to the insurance settlement that we should be aware of that may be coming in incoming quarters?

Matt Murphy
There is probably a significant restoration fee coming in the second quarter. I don't want to get too specific, because those are always negotiated deals. I call them one-time items; we probably have a restoration fee or two or more every quarter. The fact that they approach seven figures gets to be a little bit unusual. That's the only one I can really think of, and yes that transaction is included in guidance.

Manny Korchman
So, maybe the total magnitude of those types of events in guidance for the year, if that doesn't tip your hand too much?

Matt Murphy
Well, to be honest, that's the only one. Other than what's actually happened that's the only significant—again, "one-time item." I don't like that characterization, necessarily. They're less common. That's a natural part of our business, the fact that it's that big. There are probably other ones that are smaller fees that are out there that I'm not thinking about. That's the only significant one that I can think of that is included in guidance.

Phi Hawkins
By the way one ancillary benefit of a strong market is this kind of situation, we're negotiating leases and enforcing leases in a way that perhaps in a weaker environment we may not be able to. Or, if you're dealing with a weaker credit tenant, you may not be successful. I consider this another one of many examples of a strong market, and where our property management teams and market teams are really mindful of those leases and extracting revenue that we've earned and we deserve, but perhaps a team that is not as diligent, or a market that's not as favorable, we may not be getting them.

Manny Korchman
Great, thanks.

Operator
The next question is from Eric Frankel at Green Street Advisors.

Eric Frankel
Thank you. I wanted to talk about the revised disposition guidance and the equity raise. Is that all in reaction to where lower quality properties are pricing today?

Phil Hawkins
No, not at all, actually. Guidance has been reduced by actually reducing the top end of the quality of the

assets we were expecting to sell this year; assets that our market teams would rather not sell. But when compared to the use of capital, i.e., the development pipeline that is performing very well, made sense. As Matt mentioned, liquidity and pricing, it made sense to us as we evaluated sources and uses of capital and potential other sources of capital to do that. As Matt mentioned, there's nothing in the plan to sell more. I'd say it's unlikely we will, barring a substantial increase in development pipeline. What we are continuing to do is sell the assets that we consider to be nonstrategic, the assets that our market teams want to sell for whatever reason, as soon as we're able to sell them from a leasing perspective.

Eric Frankel
Do you have a rough sense of what percent of your portfolio you'd consider nonstrategic today?

Phil Hawkins
Well, it depends on the price, and depends on what we've accomplished. What we're selling today is far better quality than we were a year ago. The West Chicago, which we've sold is a submarket that Neal has not targeted. He, for a variety of reasons, and he can probably describe it far better than I can, we're not big fans of that submarket. We love Chicago, and obviously, we're growing a lot in Chicago. We've got a couple of buildings in Indianapolis that we're working on selling right now that we would certainly consider nonstrategic. Had some good leasing success recently; working on that. A couple of nonfunctional or lower functional buildings in Cincinnati are on our list. I'm probably being more specific than I should be.

And we are talking about a couple of buildings here and there, frankly, and then there's probably a market or two that I'm not thinking of where we've got a building or two. We're talking about a handful of buildings left that at the right price we're sellers, and the wrong price we're holders. We're not highly motivated sellers, but we are prepared to sell the lesser strategic, the lower growth assets that are more attractive to other types of buyers, other types of owners than they are to us.

Eric Frankel
Thanks, for the more detailed comments. I'll have a couple of follow up questions. I'll jump in later in the queue, but you talked about how supply is still relatively disciplined. Are there any markets in particular, though, where you feel like you might be a little bit stretched? I mean, we've obviously heard some other management teams make their comments over the last couple of weeks.

Phil Hawkins
From a supply perspective?

Eric Frankel
Yes.

Phil Hawkins
I guess I'd pick on some of the same ones. I worry – Dallas is on fire from a demand perspective, and where we are focusing on, which is north, and by the airport, north/northwest, and in smaller and medium-sized buildings, is in great shape. Demand in that market, just defies historical perspective. But on the other hand, so does supply. To me, when you see high demand, high supply, you're creating leverage there where at some points that can turn on you. No doubt about it.

I would say we continue to think about and talk about, Houston. I was with Justin two weeks ago; had a great trip. That market continues to hold up well. There's 10 million square feet under construction there, 400,000 of it is in a build-to-suit for one tenant under one roof, which is a pretty amazing situation. And another 800,000 feet of that, so almost 5 million feet, in build-to-suits. The other 800,000 is for FedEx. So, you've got to have Houston on that list. Not for any statistical or research that shows on the data today, but you've got to have it on the list.

We like eastern Pennsylvania; I know one of our peers mentioned, I think it's more Pennsylvania, which is too generic, too broad. I would agree with the comment that eastern Pennsylvania is in good shape, good demand. Our focus there is on small to medium buildings, not the big boxes. There's certainly big box demand, big box growth.

Central Pennsylvania, we don't have a big presence; it's a little bit less land constrained than eastern Pennsylvania. Strong demand, it's a major distribution market, but I don't put Pennsylvania on that list, but I comment on it because I know a few of my peers that have gone before us have on both sides of that coin. That'd be it.

Eric Frankel
Okay. I'll jump back in the queue. Thanks.

Phil Hawkins
Okay.

Operator
The next question is from Steve Sakwa, at Evercore ISI.

Steve Sakwa
Thanks, good morning. I was wondering if you could just maybe talk a little bit about tenant psychology and demand. Phil, I just wanted to follow up on the comment you made about a couple of the buildings, or maybe it was Matt who talked about some of the leases that you weren't expecting that happened very quickly. I'm just curious as you're out talking to tenants, what their expectations are about the economy, how they start to think about leasing, and some of the bigger issues that you're talking to them about.

Phil Harris
That's a perfect question for Bud Pharris to start with.

Bud Pharris
Yes, great question. What we're seeing, is size requirements, not just the big box spaces, but now less than big boxes; smaller infill needs are really heating up. And, in some instances, and this has been going on for a couple of quarters now, some of the tenants that are stepping up to the plate are not doing so and making decisions quick enough and they're actually getting bumped for other tenants who really understand how important it is to act quickly. So, that's one of the phenomenons we're seeing. The activity's been very strong.

Steve Sakwa
Okay, and I guess second, to maybe go back to a question John Guinee asked just about development, Phil. As you think about it, you started the year cautious, maybe cautiously optimistic, and having been measured in the development business, obviously, it's been good. I'm just trying to think what other steps or what other measures are you putting in your underwriting to minimize risk besides just not land banking? Are you just thinking about anything differently? Longer lease ups, or haircutting rents, or putting in bigger contingencies? How do you think about it this late in the cycle?

Phil Hawkins
Nothing different from what we've been doing, but a friendly reminder; each time I see employment growth this morning, or whatever, to be diligent about doing what we said we were going to do. Really, honestly underwriting assets and markets to make sure that we're not believing our own rhetoric. I can tell you,

the length of each investment committee meeting is significantly longer today than it was two years ago. We've kicked a number of projects aside because they were mediocre locations and they work in today's market, but not if today's market goes away. Or, returns that we just didn't feel we were getting enough.

We've had several projects, particularly when they get auctioned where we, once again, just like buildings, it's pretty hard for us to compete in an auction environment when we've got the capability to create land and create land opportunities and others don't. And those others may have bigger appetites or lower cost of capital, or whatever. So, I think it's just a reminder. As I said in the last call, risk management from a corporate level, is really important, as is project underwriting at the local level.

We've got, I consider them great debates; our market leaders may not think they're as much fun, but they're incredibly important. I want to make sure we don't turn away projects that are quality projects. On the other hand, I really don't want to believe our own rhetoric and talk ourselves into something that really shouldn't be talked into if the market wasn't this good.

The market's great, I see no signs from tenants and brokers in our own activity that that's going to change, but clearly we know it will change someday, and I just want to make sure we are managing the company as if that will happen, but not managing the company believing it's going to happen tomorrow. Because I don't.

Steve Sakwa
Okay, and, just remind me. Do you have any parameters or guard rails, or max development levels you think about? Total spend as a percentage of enterprise value? Just remind us sort of how you think about development relative to the size of the company.

Phil Hawkins
Yes, no more than 10% of our total assets should be in the form of at-risk development assets and redevelopment. Build-to-suit wouldn't necessarily count against that, but certainly speculative development would. We've not come up, I think we're about 7% or 8% right now, Matt, in total development, and that's 60% leased. Although much of that development pipeline started off as spec.

Then, it's really by submarket, not trying to compete with ourselves. No matter how bullish we are, we really don't want to get over our skis and be overly confident, again, by doing two or three instead of just one even though we might believe two or three projects today might work. It's just we're trying to take a measured, meaningful bet on development, but one that is manageable from a company perspective.

Steve Sakwa
Okay, thanks a lot.

Operator
The next question is from Juan Sanabria, at Bank of America Merrill Lynch

Juan Sanabria
Hi, good morning, thanks for the time, guys. You guys mentioned a lease on a development to a premiere e-commerce retailer. Would that be a new build-to-suit, or would that be to fill a current development that's not yet leased?

Phil Hawkins
Neither. An existing, second-generation operating building that we have leases out. Now, again, I mentioned it as an example of e-commerce activity, not as a guarantee we're going to close the deal. I'm sure Mike Ruin is going to shoot me for even talking about it, but no, it's an infill, existing building,

second generation, good quality building, but not a new development or redevelopment in that case.

Juan Sanabria
Okay, great.

Phil Hawkins
By the way, that's not the only example where our existing buildings, non-development/non-redevelopment have benefitted from direct e-commerce related business. There's a lot of business out there you have no idea, particularly 3PL business, but even some direct user business, that it's harder to measure whether it's e-commerce or not, and what percentage. But clearly, when certain names you know what's going on in there; other names, you don't.

Juan Sanabria
Okay. And then, just on the releasing spreads; been very strong the last few quarters. Any color on expectations for the balance of the year? Is the first quarter a good run rate or are there tougher comps with what's expiring coming up for the rest of '16?

Matt Murphy
I do think it's representative. As I've talked about a number of times before, the easiest way to measure that, because you don't have to have as precise a knowledge of where market rents are, is if you just look at what the lease comps are. And what's remaining for 2016, and just to refresh anybody's memory, the way I think about it is, are the comps pre-recession, during the depth of the recession, or post-recession, for the full year, there was 42% of it that was in the depths of the recession; i.e., the easiest comps. The remainder of the year, it's slightly lower than that, but it's in the high 30's, it's not a lot lower than that. So, I think it's representative. That's not a prediction. You're never going to get a prediction out of me on this, but the environment for the rest of the year's not any different than the environment for the first part.

Juan Sanabria
Thank you.

Matt Murphy
Yes.

Operator
The next question is from Blaine Heck, at Wells Fargo.

Blaine Heck
Thanks, good morning. Matt, just wanted to get some color on same-store NOI. I hope I didn't miss this, but you saw same-store expenses decreased again this quarter. Did that have anything to do with snow and ice maybe being high last year, or some other one-time item? Or is that a sustainable decrease going forward?

Matt Murphy
That is exactly—it's not all of it, but that is by far the biggest piece of it. We actually had a number of markets that had a pretty tough first quarter this year, too.

Phil Hawkins
Including your hometown, right? Your current town.

Matt Murphy

Yes, right. So, but that is absolutely the biggest driving factor.

Blaine Heck
Okay, good. That's helpful. And then maybe, Phil, can you just talk about the three speculative developments you guys started this quarter? What makes you confident on the demand side in those markets?

Phil Hawkins
Our experience. They are markets we've already developed in. Pre-leasing activity is another example, and frankly just our understanding of the overall market. We're talking about Orlando, Miami, and Atlanta, all very strong markets. Markets where we've got a good track record in.

Miami project is literally right next-door to what we had done a couple of years ago. Orlando is part of the same park we've been developing. Atlanta is a site we've owned for a number of years, bought our joint venture partner out recently. We've got a number of buildings around that area. We are imbedded in these markets with strong market teams and a lot of experience.

Blaine Heck
Okay, then maybe one quick last one. On the 400,000 square foot tenant in Atlanta that stayed in place, did you guys do a short term extension on that, and should we be aware of that coming up again soon, or was it a longer term deal?

Matt Murphy
The short term extension is what got us from January to—they're out of the building. They moved out April 1st.

Blaine Heck
Okay. Thanks, guys.

Phil Hawkins
And Blaine, congratulations or maybe condolences, I'm not sure which. On sitting in the number one chair. We look forward to working with you.

Blaine Heck
Thanks, I appreciate it. Thanks.

Operator
The next question is from Craig Mailman, at KeyBank Capital Markets.

Craig Mailman
Hi, guys. Just curious, following up on Bud's comment about this infill tenant demand and how some tenants aren't being quick enough, and just as that relates to rent growth. Just curious, the elasticity of demand in your infill markets versus what you guys are seeing in non-infill?

Phil Hawkins
Bud, you want to handle that one?

Bud Pharris
Sure. I think the non-infill markets are still very strong. There's quite a bit of tenant activity, but the infill markets, literally, tenants, they don't have options. So, in some instance where tenants might try to go out and find a different alternative, they're finding that the ability for them to find those alternatives is

really nonexistent. And then the landlords are renewing and/or extending at favorable rates, and I think that's where you're seeing much of the activity and rent growth.

Craig Mailman
So, I guess, if we're looking at your ability to capture the market to market, maybe there isn't one, but just your sense of if rent growth has been 5% to 10% in infill or even more, how much that a multiple of what you guys are seeing in non-infill? And your ability to get that because of the lack of supply?

Phil Hawkins
Hey Bud, maybe a comparison of Inland Empire East versus West. We don't have much in the East, but I think is an idea.

Bud Pharris
Yes. We really don't. I think it's a great point, Phil. We don't have a ton of exposure in the Inland Empire East. But I would say that from an occupancy and rent growth standpoint, the West clearly—I shouldn't say clearly—the West does better than the East. The rent growth is better and it's stronger, and frankly, the occupancy is better, and there's less construction in the West as there is in the East, and there is fewer barriers to entry in the East. It's a fairly common cycle that we see, but we're still very bullish on what's happening, clearly in the infill, but in the non-infill or the outer infill, we're still very confident and feel very good about what's transpiring from a fundamental standpoint.

Phil Hawkins
Craig, from my perspective, unlike last cycle or even the last several cycles where tenants would chase lower cost deals and further out locations in most major metropolitan areas, in the next cornfield on the interstate further out, what we're seeing now is tenants are paying up to be closer to the urban core. They're not reacting—the price elasticity, I think that was your word, is indicating that there are other costs or the benefits of being closer to the urban core far outweigh the cost that we're charging and the rent growth that we're seeing.

There are always exceptions, but if you look at every market—even the Midwest markets, the closer in you are with land or buildings, the better you're doing and the more you are able to push rents. Which has been our theory, frankly, for 10 years as we've been repositioning this company, is we really want to be in markets that are closer to the urban core, not as susceptible to excess land, an easy building environment. I think from a real estate perspective that makes sense, but it makes sense also from a tenant's perspective. They want to be there; they're paying for it.

Craig Mailman
Okay, that's helpful. That dovetails to my follow up here, as you guys think about what's non-core at this point. Is it more of a bottoms-up, or a top-down in terms of how you think the portfolio should be positioned longer term to capture this move to more urban and the realization that to be same day you need to be there to eliminate some other costs that previously people had just underestimated or ignored?

Phil Hawkins
Well thankfully it's both, because the market leaders, I learn a lot from them, as does Teresa Corral who runs asset management, dispositions, and actually, the acquisition process. But we see it the same way. What we want to do, is be where our market leaders believe the future of their markets is. and that specific submarkets, it's certainly a general philosophy of closer in, more barriers to entry.

We think about even Dallas, where you don't describe Dallas as a high-barrier to entry market, but the submarkets that Art Barkley's has been able to identify land and assemble tracts of land from five sellers, are truly infill with barriers to entry and lack of land. That is much more attractive to me than going south in Dallas, and competing with four or five major developers that are building million-foot projects. That's our strength. To stay infill, to work hard and invest a lot of time as well as money into assembling and creating infill development opportunities. But then, as far as specific asset selection, it's very much bottoms-up. Market leaders work with Teresa to identify assets from a financial perspective and an operating perspective that they believe are the lower part of their portfolio. And then we begin to look. And then that starts the process of evaluation, a little more financial scrutiny, and eventually as leasing permits, pull the trigger to put on the market and then as pricing permits to then pull the trigger and sell it.

Craig Mailman
Great. Thanks, guys.

Operator
The next question is from Mike Mueller, at JPMorgan.

Mike Mueller
Hello. A couple of quick ones. With respect to the tenant who moved out at the end of March, are you expecting occupancy to dip in Q2, or do you think you hold the line there?

Matt Murphy
Yes, it will, that's 60 basis points all by itself, I do think it will drop a little bit. I said that three months ago, too. But yes, I do think it is and there are a couple of other tenants that are in excess of 100,000 square feet that have moved out in April already, so yes, I do believe it'll dip a little. I don't think it'll be significant.

Mike Mueller
Got it. And then just when you talk about that restoration fee in the second quarter, did you say that that was in guidance, or was not in guidance?

Matt Murphy
It was in guidance, sorry if I was unclear.

Mike Mueller
Okay, no, that was it. Thank you, bye.

Operator
The next question is from Ki Bin Kim, at SunTrust.

Ki Bin Kim
Thank you. Could you talk a little bit about SCLA? I noticed that one of your development starts was in that location. I remember back in the day that was one of the upside options for your company. Just curious if that has become a more viable use of land, or you can maybe start more projects on that piece?

Matt Murphy
Yes, I think it clearly, activity up there has been very good. We started a building that was a quasi-build-to-suit. There was a tenant that signed a 10-year lease that basically leased half of what became a 445,000 square foot building. We felt very good about the potential for existing tenants in the park to take the remainder of the building, and that's exactly what happened. We believe there is still more demand for exactly that sort of thing.

There is clearly a lot more activity up there in the last 6, 9, 12 months than there has been since before we got into the recession. The nice thing about the structure that we have at SCLA is we have a very low land basis that allows us to—we bought the land that we have out there for $0.02 a foot. It allows us to be patient, allows us to capture. There are very compelling reasons to be in Victorville for specific companies that continue to respond to that being a good fit for what their business is. Yes, the activity is better than what it has been in recent memory.

Ki Bin Kim
And could you just remind us also of some stats? Last time I remember you guys have about 4,300 acres under option. Any update on that?

Matt Murphy
Well the structure hasn't changed. The redevelopment, there is a very long answer to that question that's probably not worthy of this forum. We have as much land—the beauty of that structure is we have access to a lot of land, but not obligations to a lot of land. We have access to more land than we are likely to use in the time frame that any of us care about. As activity goes, again, that's the beauty of the structure. We can take down land as we need it, it's not that simple, it's not like going to K-Mart; but there is a mechanism for us to take down land that will satisfy the needs that we have for the foreseeable future.

Phil Hawkins
I would also say that our team there has done a great job maintaining a relationship with the redevelopment authority in the city of Victorville, which will help us react to tenant opportunities and react to changing markets. We're working on an idea right now that may result in I think our acquiring some land in a very nice basis. So I just think that it's going well there. Nothing's changed as far as it's got a great set of amenities, and offers strengths that if they're important to tenants they're going to want to be there; and if they're not, they're not.

Ki Bin Kim
Just any general expectations for how much you're going to start there over the next year or two?

Matt Murphy
No. Again, I think I'm not sure how useful it is to start projecting that far out into the future. We're confident in the activity that's going on now.

Phil Hawkins
I think it's going to be more than zero.

Matt Murphy
Yes, it will be more than zero. I'm comfortable with that.

Ki Bin Kim
All right, thank you, guys.

Operator
The next question is from Tom Lesnick, at Capital One Securities.

Tom Lesnick
Good morning. Just a couple quick ones on same-store to start. Obviously, 5.4% in Q1 is higher than the 4% to 5% range for 2016. First, can you talk about the quarter-by-quarter cadence of new, tougher comps expectations heading into the last three quarters of the year?

Matt Murphy
Yes. I think it is. Ironically, the toughest comp is going to be the second quarter, and it's just the way

occupancy, the way the ebb and flow of NOI goes, the toughest comp we'll have for the year will be in the second quarter. The numbers are predicated on the idea that we will continue to have strong demand, and therefore you will see occupancy climb up modestly through the year. So frankly, the second quarter is the toughest comp. Beyond that, we had a pretty good year in '15 throughout. The specific NOI numbers for the pool that we're comparing against, the toughest comp is the second quarter.

Tom Lesnick
Got it. And then the 40 basis point upward revision in the range, was that solely due to Q1's outperformance, or are you baking in stronger expectations for the remainder of the year as well?

Matt Murphy
A little bit of both. Probably 50/50. That's a cop out answer, but I think it's mathematically true. We had both of those leasing wins that I talked about. Obviously, the building, the 400,000 that didn't move out isn't a same-store building because we bought it in '15. Both of the leasing wins that I talked about are same-store, and they were both supposed to be down for meaningful parts of the year according to the budget. So, it's a little bit of both.

Tom Lesnick
Thanks for that. And then, just looking where your stock price is right now, I know you talked about no expectations for further equity issuance this year, but if your stock remains elevated where it is today, is there any propensity to over-capitalize or just take advantage of the pricing in the market today to shore up the balance sheet even more than what you're contemplating?

Phil Hawkins
Probably not. We've already brought down our debt to EBITDA metrics, we've got a run rate of EBITDA that's being created through the develop pipeline that's going to be a tailwind on that. I feel like we already have de-levered. No plans to de-lever further. Clearly, it can happen by great development leasing that generates EBITDA quicker. Or, frankly, more likely to happen if we got an unsolicited offer at a good price from a user for a building that wasn't in the plan, we'll sell. We are not going to not sell. We're happy to sell for the right price, even if it wasn't in our "plan" if it's a building and a price that we think translates into a sell decision, but it won't be because of equity.

Tom Lesnick
Makes sense.

Matt Murphy
I like the way Phil said it earlier. To me, the only thing that significantly raises the potential to do this, is if we start seeing uses of capital that are well in excess of what we have in our business plan. I don't think it makes sense to go out and issue a bunch of equity for momentary reasons. I think our capital plan contemplates our strategy, contemplates our level of activity, and it doesn't seem like the right thing to do, to jump in because we can. I think our investors have, and will continue to reward us for being prudent in terms of how we raise capital for the Company.

Tom Lesnick
Appreciate that insight. And then, just one final one for me. Can you talk a little bit about your development underwriting on build-to-suits? Do you guys underwrite to a specific rent, or are you underwriting to a specific yield and building in clauses where any cost overruns or savings are passed along to the tenant in the form of the price?

Phil Hawkins
Well, we're not a big build-to-suit player. We don't have a land bank, which makes it hard to be a build-

to-suit player. What we're doing is pre-leasing buildings that we've designed. We are leasing that market rents, not some cost plus, typically. And we are taking the development risk, which we're very comfortable doing.

We've been doing this quite a while, we've got a great track record on cost management. In fact, they've all come in under budget. We've got healthy contingencies in there. Like I said, we're not in the construction, build-to-suit design/build world. We are in the we want to build buildings that we want to own. We're happy to lease them sooner than we expected, and we've been fortunate to do that pretty regularly. But like I said, we are not in the cost plus game, building their building, at some cost plus arrangement.

Tom Lesnick
Got it. Really appreciate the color, guys. Nice quarter.

Operator
The next question is from the Mitch Germaine at JMP Securities.

Mitch Germaine
Just a quick one from me. Phil, just curious about some of these markets where you've got just a handful of assets; call it ten or less. What's the plan for them over time?

Phil Hawkins
Well, I'd say, for example, Charlotte, we have one building. We bought it in a portfolio at a phenomenal price. We love that building. We actually bought out our JV partner in that case, a fairly large transaction; I don't remember the total size, but it was a pretty healthy transaction. A couple $100 million, if I remember right.

We love that building, knew that building, knew the tenant had a short term lease left on it when we bought it three years ago. Tried to renew it early to sell it, the tenant wanted to stay, but what they wanted to renew it at we thought was not a price we wanted to pay. We're now hopeful of renewing that tenant, we'll probably sell it. While we love the building and location, it's just I'm not sure it makes sense on one building in Charlotte.

There are a couple of markets where we don't have people, we may look for opportunities. But, for example, we don't have anybody in Nashville. We've don't have a huge portfolio. Love that market, and love the rent growth embedded in our portfolio.

Hard to buy in that market, it's very competitive. But on the other hand, we like what we own, not likely to exit any time soon. Just as an example. On the other hand, small markets where we've got good teams, our competitors, most of whom are also driving or flying in, we cover that out of Atlanta. The Atlanta team does a great job, so as an example, unlike Charlotte, that's not likely on the exit list.

Mitch Germaine
Great. That's helpful, thank you.

Operator
As a reminder, to ask a question, you may press star then one. Our next question is from Eric Frankel, Green Street Advisors.

Eric Frankel
Thank you. Just one quick comment. Matt, you talked about taking down land at SCLA. I think you

could think of a more expedient retail experience than Kmart, just based on the online [laughter].

Matt Murphy
So, you want to talk about an example of e-commerce, I don't do a lot of actual shopping any more.

Eric Frankel
It is quite ironic. Question for you, Bud. Obviously, I can certainly appreciate that the supply seems relative to constraint, just given the demand backdrop. Can you comment, though, on what you think institutional investors are underwriting for development, and what type of yields and spreads to market cap rates they're expecting? Because from what we understand, institutional capital, it seems to be a little bit less interested today than older assets, and going more towards institutional quality or modern warehouses in better locations?

Bud Pharris
Right, so great question, Eric. We're looking at development opportunities really throughout the western region. As Phil had mentioned, we've got a number of opportunities that we're working on. But in terms of the highly marketed, or the auctioned, if you will, land sites, it's very difficult to compete because some of our competitors are underwriting to returns on costs that just are not attractive to us. We really like to make sure that we're getting paid for the risk that we're taking. On some of the deals, we're just not a player, and that's why we're looking at these other off-market opportunities, or putting together parcels of land, or things along that line.

Phil Hawkins
Bud, feel free to throw out specific, or least our view of what the stabilized yields are on some of the auctioned land sites that you've seen in Southern California.

Bud Pharris
Do I really have to?

Phil Hawkins
You don't have to; I think you're afraid to, is what I wanted to mention.

Bud Pharris
That's right, we've seen returns on costs for our competitors drop well below the 6%, into that 5.75% range. Recently, there was a fully auctioned site, that was taken down by one of our competitors, and by our underwriting standards it was a 5.45% return on cost. Our understanding is they were willing to go below that as well. Those numbers are numbers I've never seen before.

Phil Hawkins
Eric, one thing I would just comment on. Your question was right on, but your theory I think is a little off. I don't think investors are shifting away from older assets if they're functional. I don't think those investors have ever been willing to take down non-functional assets or low functional assets. The market for Functional B, we've not seen a change; in fact, it's as healthy as ever. There are a subset of investors, and I'm not sure they're linked to even those that are willing to invest in B, just those that have plenty of money, pension funds, non-traded REITs, etc., who tend to gravitate more towards ready-to-go development and ready-to-go land. They clearly have a strong appetite for development and a strong appetite for placing capital in a lower cost of capital.

But it's not coming at the expense, in our view, of functional high quality B, that market. I'll tell you, if we saw a change, we'd be more active buyers. We just don't see it, and therefore, that's why we're having to redevelop or develop. I, in some ways, wish that that market would come back because we are big believers if you're going to acquire a highly functional B asset in a great location infill, buy all day long. Unfortunately, we're not the only ones who think that.

Eric Frankel
Yes, I probably did not phrase that question exactly the way I wanted to. Appreciate that. Final question for you, Phil. I think we talked about market rent growth last quarter, and I think you gave your expectations on what market rent growth would be for the year. We know it's a pretty nebulous concept. Has your thought changed based on first quarter activity?

Phil Hawkins
Yes. Going into the year certainly at the time mindful of mixed, at best, economic reports and global uncertainty and I was still positive on the business back then, but I'm more positive even today. When you go through the first quarter, despite what the capital markets are telling you, or you think are telling you, and your tenants are behaving in a much stronger, confident way, and when you're talking to tenants—and I've met with several on my last recent few trips—you meet with brokers, what they see coming down the road, I think that demand is likely to stay strong. And given low vacancy rates, relatively disciplined supply, I think rent growth will surprise to the positive this year.

Eric Frankel
Okay. That's all for me. Thank you.

CONCLUSION

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

Phil Hawkins
Okay, well thanks, everyone, for joining our call today. Matt and I are available for any follow up questions, and we look forward to seeing many of you at NAREIT in June. Take care.

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