DCT Industrial

DCT Industrial Second Quarter 2016 Earnings Call

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CORPORATE PARTICIPANTS

Melissa Sachs - *Vice President of Corporate Communications and Investor Relations*

Phil Hawkins - *President, Chief Executive Officer*

Matt Murphy - *Chief Financial Officer*

Mike Ruen - *Managing Director of the East Region*

PRESENTATION

Operator
Good morning and welcome to the DCT Industrial's Second 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 (0). After today's presentation, there will an opportunity to ask questions. To ask a question, you may press star (*) then one (1) on your touchtone phone; to withdraw the question, please press star (*) then two (2). Please note that this event is being recorded. I would now like to turn the conference over to Vice President of Corporate Communications and Investor Relations, Melissa Sachs. Please go ahead.

Melissa Sachs
Thanks, William. Hello, everyone, and thank you for joining DCT Industrial's second 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, Mike Ruen, our Managing Director of the East 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 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 on our supplemental, which can be found in the Investor Relations section of our website, dctindustrial.com. And now I will turn the call over to Phil.

Phil Hawkins
Okay, thanks, Melissa, and good morning, everyone. Thanks for joining our call today. We are pleased to report another good quarter highlighted by continued strong leasing volume, rent spreads and occupancy. We have increased our operating and financial guidance for the year as a result of the outperformance in our operating portfolio combined with very healthy market fundamentals.

As expected and consistent with our comments on last quarter's earnings call, second quarter same-store NOI was lower than prior quarters, but based on the midpoint of our raised same-store guidance, we anticipate NOI growth to average 6.4% on a cash basis and 6.9% on a straight line basis at the midpoint for the second half of this year. Matt will go into more detail on results and guidance shortly.

Market conditions remain as favorable as I have ever experienced. Tenant demand remains robust across all markets and size ranges. Vacancy rates are at historic lows and supply remains in check, resulting in significant upward pressure on rents. From everything we see and hear on the ground, we expect this favorable operating environment to continue through 2016 and well into 2017, if not longer. Traditional distribution customers are quite active as they look to expand and improve the efficiency of their supply chains, while ecommerce-related users continue to grow as an important driver of incremental demand, especially in locations closer to the urban core and their customers. DCT's predominantly infill portfolio located in major population centers is especially well positioned to capitalize on this important ecommerce trend. In recent months, we've signed multiple leases with such ecommerce related customers as Amazon, FedEx and UPS, with additional requirements in the leasing pipeline, as well. A year ago, Amazon was not on our list of top 10 customers. Today, they are now our largest customer, reflecting their shift towards infill locations.

Shifting to our development program, we stabilized four buildings, totaling 1.3 million square feet with a projected cost of $117 million and a yield of 7.6%. These yields came in 62 basis points higher than our initial pro formas, due to both faster lease-up and better rents. Based on Class A cap rates for each market as provided by CBRE, we estimate that $60 million in value has been created from these stabilized projects, a 51% margin. Our current development pipeline is now $282 million and is 46% leased with an expected stabilized yield of 7.5%. This includes two speculative projects with projected cost of $77 million that were started since last quarter, 250,000 square feet in Seattle and 800,000 square feet in Northern California, both very strong markets that we like a lot. Leasing activity throughout our development pipeline is very strong with a number of transactions at the LOI or lease negotiations stage.

Since the end of the last quarter, we have acquired land for future development in Baltimore and Dallas and are working on a number of additional land acquisitions across our markets, which will further bolster our potential development pipeline next year. Given our positive outlook for the market, the leasing activity in our current development pipeline and our pipeline of land owned or under contract, we are expecting 2017 to be another excellent year for development starts. While our primary capital deployment focus is on development and redevelopment projects, our market teams continue to also look for the opportunity to acquire high quality buildings with favorable growth and value creation prospects. We have several acquisitions now under contract scheduled to close in the third and fourth quarter, which is what led to the increase in guidance to a current estimated range of $50 million to $100 million.

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

Matt Murphy
Thanks, Phil, and good morning. Our second quarter results and outlook for the remainder of 2016 and beyond reflect the many positive forces present in our business today. I'll walk through some of the details in the quarter and talk about their impact on our full year 2016 guidance.

Funds from operations as adjusted for the second quarter was $0.54 per share. While on the surface this was consistent with our expectations, we achieved this despite roughly a $1 million restoration fee that we expected to receive in the second quarter of being delayed until the third quarter. Better than expected occupancy and rental rate growth, combined with interest savings that I'll talk about in a moment, allowed us to more than compensate for that delay and come in slightly ahead of expectations.

Consolidated operating occupancy was 95.6% at June 30th, approximately 40 basis points above our projections. This outperformance was driven, in part, by a number of smaller tenants that both signed leases and moved in during the quarter, allowing us to almost entirely overcome the 400,000 square foot move-out in Atlanta that I talked about last quarter. Leasing on these small spaces was especially robust, with about 70% of the leases signed in Q2 being 50,000 square feet or less. While this isn't a new phenomenon, it is further evidence of the breadth of leasing demand as well as an indication of how quickly leases and move-ins are occurring in this environment.

Same-store NOI growth for the quarter was 1.3% on a straight line basis and 1.5% on a cash basis. While these results are obviously lower than our overall run-rate, they are, in fact, a little better than our expectations for the quarter and the improving trajectory of leasing volumes and rental rates resulted in a meaningful increase to our same-store guidance for the full year. As I discussed on last quarter's call, we knew that Q2 was going to be the most challenging quarter of 2016 in terms of year-over-year comparison. A number of factors contributed to this anomaly. The most significant is the decline in miscellaneous fees and other onetime items of just over $800,000.00 versus 2015. As I called out on our second quarter call last year, we had a number of large fees in the second quarter of 2015, primarily related to tenant restoration charges that contributed to the 13.3% cash same-store NOI increase in Q2 last year, our highest quarter of the year. There were no similar significant items this quarter. Another factor dampening same-store NOI growth this quarter was that expenses were approximately $1.3 million, or 6.3% higher than last year, largely due to a number of non-repetitive items. Over $400,000.00 of the increase stems from a cumulative accrual adjustment in the second quarter of last year as a result of lower than expected property tax bills and valuations. We also experienced an unusual expense for extermination costs of one property causing an almost $200,000.00 hit to non-recoverable expenses this year. Despite these temporary headwinds, the fundamental operating environment remains remarkably strong.

Quarterly same-store property occupancy was 95.3% at June 30th, despite the 400,000 square foot move-out I mentioned, which represents over 70 basis points of the portfolio. As a reminder, this was a tenant who we knew was moving out when we bought the building early in 2015. The Atlanta leasing market is very strong and we are optimistic about releasing the space at or above the rents we assumed last year when making the acquisition. The rental rate environment also remains incredibly strong. For example, embedded rent bumps contributed $1.2 million, or 2.1% of same-store NOI growth, quarter-over-quarter. Perhaps more importantly, in addition to the growth already embedded in our leases, rent growth on leases rolling year-over-year contributed approximately $850,000.00, or 1.4% growth in same-store NOI versus 2015, the largest such quarterly contribution in our history. I can think of no better illustration of how impactful the prolonged period of upward rental rate pressure we've enjoyed as having on cash flow growth. One final note on same-store NOI, given the recent focus that the SEC has placed on the presentation and description of non-GAAP financial measures, we have changed the terminology in our press release and supplemental to same-store NOI growth on a straight-line basis instead of referring to it as on a GAAP basis. The calculation is exactly the same as it has always been; only the terminology has changed.

Turning to guidance, we have raised and narrowed our 2016 guidance for funds from operations as adjusted to between $2.16 and $2.22 per share, an increase of $0.04 per share at the midpoint. Approximately $0.02 of the increase is attributable to the $250 million senior unsecured note transaction we announced in late May. The combination of lower than expected rates and our utilization of the notes' delay draw feature will result in a savings to our previous forecast of a little over $2 million in 2016. The remainder of the increase is based on better operating results. Based on improved actual and expected leasing for the remainder of the year, we are increasing guidance to average operating occupancy for the full year to between 95.25% and 96%, an increase of almost 40 basis points at the midpoint. Similarly, we are narrowing and increasing same-store NOI guidance to between 4.5% and 5.25% on a cash basis, an increase of approximately 40 basis points at the midpoint, and to between 4.75% and 5.5% on a straight-line basis, an increase of over 60 basis points. Finally, we are increasing our guidance for acquisitions to between $50 million and $100 million, reflecting the transactions we have under control as well as the pipeline Phil described. 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 results for the second quarter further enhanced the optimism we feel about our business. Leasing velocity and rental rates continue to surprise to the upside. Tenant demand driven by current logistics trends is driving activity towards our predominantly infill portfolio, where users are finding fewer and fewer options. This dynamic should continue to support further rental rate growth well into the future. All of these factors, combined with a very accommodating interest rate environment that appears likely to remain for quite some time, have caused us to meaningfully increase our operating and financial expectations for 2016 and bode well for the future beyond that. As you've heard us say many times, it's a great time to be in the industrial business and we believe that is particularly true here at DCT.

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

QUESTIONS AND ANSWERS

Operator
Thank you. 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 are using a speakerphone, please pick up the handset before pressing the keys. To withdraw your question, please press star (*) then two (2). Please limit yourself to one question and one follow up. If you have further questions, you may reenter the question queue. At this time, we will pause momentarily to assemble our roster. Our first question is from James Feldman with Bank of America. Please go ahead.

James Feldman
Great, thanks and good morning. I guess, Phil, going back to a comment you made on visibility into '17 and possibly beyond where you think you will see favorable fundamentals, can you just talk to us about what gives you that confidence? What are you looking at that tells you things will be good through at least into '17? And then, also, your comment on the development starts, why you have confidence, did you, I don't know if you said the pipeline will grow or at least be as strong in '16, but if you could comment on that also.

Phil Hawkins
I'm happy to, thank you. It starts with what's going on in the markets on the ground. What we're hearing from our people involved in leasing is very encouraging. It's deep across all customer segments, sizes, markets, and it's hard to imagine, barring some macro events that we obviously can't foresee, that that will reach any level of fatigue anytime soon. That's just, so it's just based on that combined with a belief that supply, while it's ramped up, will remain in check. And clearly, supply has ramped up, it's meeting demand, it's reflecting the fact that in most markets, vacancy rates are 5% or less and so supply right now is appropriate, reasonable, natural reaction to the market conditions. And I continue to believe, or at least I'm optimistic that will remain the case.

In terms of '17 starts, actually I didn't put a number on it or a relation to '16, but I would say, without issuing guidance, if 2016 was an over/under mark, I would take the over. And I say that because there are a number of markets where we have land under control, where we are working through entitlements of various types, where it should take, as we've talked about on the call, take longer than ever before, which is one reason why supply remains in check. And I'm optimistic, highly confident that most, if not all, of those will be successful in going through the entitlement process. I'm also optimistic that the markets, as I just talked about, will remain healthy and strong and that our own pipeline will remain healthy, which will allow us to continue to start projects that make sense, economically, from a risk adjusted return basis. So hopefully, that helps.

James Feldman
Yeah, very helpful, and then for my follow-up, maybe sticking with the '16/'17 outlook, can you just remind us known move-outs for the rest of the year and even those you know about in '17?

Matt Murphy
No move-outs for the rest of the year. There are only two of them that are more than 100,000 feet. One of them is moving into a development that we're building for them in Chicago, the other is 100,000, right on the number in Dallas that's backfilled. It's leased immediately after they leave. Beyond that, I can't think of anything that's more than 50s and 60s. So the back door, as I call it, it looks really good for 2016. 2017, I'm trying to think, I don't know of a single significant tenant that's thrown in the towel yet. So I don't know of, I'm not sure I'm willing to characterize anything as a known move-out in '17 yet. To be candid, I haven't really drilled into that level of detail in '17 as much as I obviously have for the back half of '16. But I don't know of any big lumps that are out there, nothing like the 400,000 that we talked about earlier.

Phil Hawkins
The Dallas tenant is an excellent example of the robustness of this market, 100,000 foot tenant moving out and the space is already leased before they closed the door behind them.

Matt Murphy
Economically, no down time, not a day.

Phil Hawkins
I mean, it's just, those are times to be enjoyed. Like I said before in my opening remarks, I've not gotten to enjoy this very often and I'm enjoying it now.

James Feldman
That's great and then the first move-out, are they moving into one of your developments?

Matt Murphy
Yes.

James Feldman
Okay.

Matt Murphy
250,000, yes.

James Feldman
All right, great, thank you.

Operator
Our next question is from Manny Korchman with Citi. Please go ahead.

Manny Korchman
Hey guys. Matt, just wondering what you're looking at in terms of larger acquisitions and how you think about funding those, whether it be through secondary, larger raises on ATM, whether you just raise leverage on the, answer those two for me. Thanks.

Matt Murphy
Yeah, I would think, certainly, raising leverage is not going to be the answer. Ultimately, whether or not it's going to be funded through equity or through property dispositions, is a function of timing, where we're at on the disposition process, etcetera, and then whether it's an ATM or an overnight is really a function of size and how much certainty we need. If it's a bigger deal, is the way you describe the question, that lends itself probably more to an overnight deal. If it's a $10 million, $15 million deal and we were going to use equity, it would be lend itself better to the ATM.

I think, clearly, given where our stock price is today, I don't think we will look at this equation any fundamentally, any differently than we have in the past. It starts with the uses. If you're excited about that, it's an evaluation of whether or not dispositions or equity is a better source of that. Clearly, with our stock price where it is relative to where it was 90 days ago, we would look more favorably about issuing equity. But the fundamental evaluation of what the best source of capital is hasn't changed and I don't see why it will.

Phil Hawkins
Let me just, one real quick clarification, additional color on acquisitions. I think to the extent we do them, they'll be similar in character to what we've done in the past, which is leaning towards one-off transactions, hopefully many of them, if not most of them, off market or lightly marketed. I don't think it's likely you will see any large transactions out of us. We look at them all, assuming the ones that we're able to see, anyway, and it's just hard. Oftentimes, the bigger they are, the more difficult the pricing is; the more eclectic the portfolio sometimes can be, and we're just not willing to sacrifice our view of appropriate economic returns as well as our belief in the importance of a strategically consistent portfolio with our own portfolio. So I think you're more likely to see, to the extent we do acquisitions, one-off transactions and nothing in a major size, but you never know, but that's my current expectations.

Manny Korchman
And so if we go back to your earlier comments about development just taking longer, especially in longer entitlement processes, is that true for sort of development across the size scale? Are you seeing any kind of bifurcation in that comment between smaller buildings, call them, 150,000, 200,000 square feet and then the mega buildings?

Phil Hawkins
Not much difference. A couple of comments: One, a lot of the delays, frankly, municipalities are backed up. They don't have the staffing to deal with permitting and they've got, it's not just industrial buildings, it's all sorts of construction going on in housing and so this, the backup, number one. Two, particularly in the infill locations, we're focused on, communities are rightfully thoughtful, it would be, I guess, is the politically correct way to say it, about what they want in their backyard and, frankly, trucks are not on the highest part of their list. So, that's part of it. That's not really related to size. I'd say then, when you get to bigger buildings, to the extent they move further out into less infill locations, clearly that's a little bit easier, but that's more a function of location than it is of size. And then, lastly, it can take time as you are developing infill, you're dealing with issues. You're solving wetlands, environmental, things that are not just

straight permitting processes that we think are very worthwhile to invest in, but take time.

Manny Korchman
Thanks, guys.

Operator
Our next question is from Eric Frankel with Green Street Advisors. Please go ahead.

Eric Frankel
Thank you. Matt, could you comment on the debt capital markets and how that's changed over the last 90 days or so? And if you had to issue debt today, how'd you do it and what rate you could probably obtain?

Matt Murphy
Well, clearly, obviously, the Treasury environment has gotten quite a bit better as a result of Brexit. I think you've seen an awful lot of issuance lately and at some pretty sporty handles. I think you'd probably, so we did the deal that we priced in May, was a 10-year at 3.90 percent average interest rate. It's probably 25 basis points inside of that today. And in terms of, I think the private versus public debate, I'm not sure if it's fundamentally changed, I think the public markets are, frankly, a little bit, feel a little bit more conducive to me today than they did 70 days ago or whatever it was, but ultimately, that's a determination you make at the time you do it.

Eric Frankel
Okay, second broader question, anyone can answer. Are there any markets where there, I know supply, overall, seems somewhat rational, are there any particular markets where supply might be a little bit worrisome? Mike, maybe you can potentially comment on Atlanta where we've seen some pretty big gains in construction starts?

Phil Hawkins
Let me start and I'll hand it off to Mike for Atlanta. The one I would watch closest, but I wouldn't flag yet, but I'd certainly watch it closely is Dallas. 21 million square feet by at least one or two research firms' count, under construction, it's a lot. Demand, though, it's probably the most robust demand market we are in and that's, I probably do another market or two disservice, but it's certainly incredibly robust and you can always bifurcate Dallas, which sometimes could be a dangerous exercise, but you can do infill smaller building development that we're doing and some, actually, I think a lot of our public REIT peers are doing, where we're in North Dallas and near the airport and more supply constrained and where we are just, we're leasing it almost as fast as we can start it. But so, but on the other hand, if you have 21 million square feet under construction, that's a fairly levered environment where, if demand does soften, it's something to be watching closely. Mike, I'm going to let you talk about Atlanta.

Mike Ruen
Sure. Well, we always watch Atlanta closely and, obviously, construction has ramped up pretty quickly, but you have to keep in mind, too, Atlanta was late to the recovery. So we're early in producing space in a market that lagged for some time. The dominant construction type remains bulk, which bodes well for us. As you know, our strategy is more infill, but overall, the market remains very healthy, high levels of pre-leasing volume. So we feel that Atlanta is very much in check and, again, even in a market like Atlanta where you can move out beyond exits for your bulk product, entitlements, timing to get the space to market is challenging. So we feel pretty good and Atlanta is very much in balance.

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

Operator
The next question is from Craig Mailman from KeyBanc Capital Markets. Please go ahead.

Craig Mailman
Hey, guys, I just want to follow-up on the decision tree between further dispositions and equity raises here to fund developments and acquisitions. You guys have been a big disposer of assets, you repositioned the portfolio. I'm just curious, as you look today, how much of the portfolio stuff that you still feel like you really need to sell to see if they're slower growth or not just synergistic versus the one-off to help fund your capital needs versus when you have equity here that's trading mid-4s on an AFFO yield for '17?

Phil Hawkins
Well, this is Phil. It's great to have multiple sources of capital and it's a high-class problem that we're grateful to have. I think our first priority always remains to manage the portfolio. We've made a lot of progress and I've said on the last call or two, we've really come near the end of that, but you always have assets that from a functional perspective, you just would rather not own and we have a few of those, not a lot, but we have a few of those and we are, they are in the queue and, based on leasing and market conditions and pricing, that will be, they will be sold, frankly, whether we need the capital or not, we'll de-lever. We will not sacrifice the timing of those sales to either wait for additional acquisitions of development spend or whatever. So I think that that's a priority and will remain so.

And after that, we are fortunate to have really good assets in markets that are doing really well and a stock price that clearly would say it's not inappropriate to access in a modest way, anyway, to source capital and we're talking about it literally almost every day, certainly, several times a week as we're thinking about it and whether we put new assets on the market, what they are, the person, Teresa Corral, who runs this position is very much a part of that process and she's in touch with our market leaders and our regional heads on a daily, if not weekly basis, as well. So it's a fluid continuous, I wouldn't describe it as a tree as much as more of a process in an ongoing conversation and we'll just try to keep making the best decisions we can based on how quickly do we need the capital, how quickly something emerges as an opportunity to use capital and then the relative merits of each of the sources.

Craig Mailman
Okay, that's helpful and I guess follow-up would be on just acquisitions in general and the conversations internally. Your peers have been more hesitant to put capital work into stabilized assets just given pricing, but just curious if your thought process is changing as you see where the tenure has trended to and it's been kind of sticky and where your stock price is, if you are more willing to think that there's value to put capital to work into stabilized acquisitions at these levels, because maybe cap rates maybe stickier and you could just lose out staying on the sidelines?

Phil Hawkins
Well, whether it's stabilized or high or somewhat vacant, I think I look at growth and, well, let's start with the asset first and then you get the growth. Some of these markets where rental rates have moved 20%, 30%, 40%, growth is, you can achieve growth, not by buying stabilized assets in a non-auction environment, preferably, because clearly there's a lot of demand for capital. And I think the only thing that's changed in my mind that has a very modest impact at

the margin of my thinking is post Brexit and looking at the forward yield curves. Clearly, the market believes we're going to be in a low interest rate environment for a long time and I, therefore, likely a low cap rate environment for a long time. And that, frankly, wasn't my thinking or my bias six months ago.

I think for a long time, we believed, many of us, maybe all of us on this phone call, believed that we were in a temporary phenomenon where interest rates and, therefore, cap rates may be artificially low due to external forces that may not remain. And whether those external forces remain or not, it feels like the world believes that cap rates, or at least interest rates, will remain low, which has some influence. But it goes back to the asset. Do we like the asset, do we like the location, do we like that market and submarket, then do we like the financial profile, the economic profile of that asset or what we believe it will be over the next 5 years or 10 years, and then we decide whether we think that's sufficient to buy it.

Craig Mailman
That's helpful, if I slip to the third one, what are the yields on the acquisitions you guys are looking right now that are under contract?

Phil Hawkins
I would say mid-4s to low-7s and for various different reasons, easier to talk about them once we have them and why, where I think the thought process was. But again, initial yield is interesting, it's certainly relevant to talk about, but I'm more focused on return over time than I am about return on the first year.

Craig Mailman
Great, thank you.

Operator
The next question is from John Guinee with Stifel. Please go ahead.

John Guinee
Great, thank you. Hey, Phil and Matt, both of you guys mentioned your high quality infill portfolio and I'm just looking at the world from a 50,000 feet as a lot of people are. It's pretty easy to categorize Northern California, Southern California, Baltimore, Washington, Jersey and Seattle, of which totals us 18 million of your 63 million square foot portfolio, less than a third as infill. Can you sort of walk through your other major markets and talk about which assets you think are infill and which ones are more commodity, focus on maybe Atlanta, Chicago, Dallas, Houston, Cincinnati, all of which are 3 million square feet and above?

Phil Hawkins
Yeah, I would say, you've got to focus on major markets, not just coastal markets and even within coastal markets, you can't just put all Southern California and do one category. Those are out in Beaumont and Inland Empire East, I would find that hard pressed to call infill. We're not in the Inland Empire East area; we've got one or two buildings. I'm not going to go through every building in every market, but I can tell you Chicago, Dallas, Atlanta, South Florida, you probably mentioned Baltimore or Washington, we have, the vast majority of our portfolio is inside the traditional kind of outer edge of development and of even the more recent development. We are absolutely in most markets, all markets in almost all of our portfolio and we'd be happy to actually tour you around, which would probably be better. I would describe that as inside the traditional outer barrier, I would call it infill.

John Guinee
Great, thank you.

Operator
Our next question is from Blaine Heck with Wells Fargo. Please go ahead.

Blaine Heck
Great, thanks, guys. Starting on rent spreads, they were pretty good this quarter, but declined from some of your recent quarters, especially on the renewals side. It sounds from your commentary that there's really no downward trend to be drawn from this quarter, but can you give any color on whether maybe there were any specific leases in there that skewed the number down or was it just more of a general mix issue?

Matt Murphy
Well, so yeah, I mean it's always a bit of a mix issue. I think the first quarter, frankly, was probably a little bit aberrant inasmuch as renewals were such a high number relative to new leases. It's generally kind of the other way around. There's always, I can almost always point to a lease that's driving some of the numbers down. We had a 150,000 square foot renewal in Cincinnati that was coming off of what were really sort of record rates. It was a highly improved space for a tenant that had pretty special needs with regard to some of the fit-out that they had on the space and so, well, that's 150,000 that was like 2.5% growth. It is still a rental rate that's well above market. It's hard to get, it's an interesting debate that we go through all the time, which is as you put in more expensive improvements and the people are paying for them, that's clearly been the case for multiple years. What happens when that tenant renews, the saying is that they won't pay for it again, well, the fact of the matter is, if they leave, they will pay for it again. So it always ends up in a bit of a wrestling match. I guess the last comment I'll make is that one of the things I've always been reluctant about predicting, rental rate or rent growth predictions, is that quarterly it moves. So yeah, we were done from the 23% we were last quarter, down to 15.7% this quarter. Let's not get blasé about 15.7% rental rate increase. So I do agree with your statement that, obviously, the trajectory is down quarter-over-quarter, but it still reflects an unbelievably healthy market.

Blaine Heck
Sure, that's helpful.

Phil Hawkins
It's not the first time we've been up and down and [multiple voices]

Matt Murphy
It always will be.

Phil Hawkins
It's been not volatile, it's been up and down, I keep looking for the right word. It is a metric that will move quickly, easily because it's a relatively sample size, quarter-to-quarter, and I think it's better to look at it over a certain period of time, 6 months, 12 months, not 3 months.

Blaine Heck
Right, okay, and then, Phil, maybe can you talk about land prices? It seems as though they've increased quite a bit in the last year or two. Is that a trend you guys see continuing as we go forward and do you think that that may start to have an influence on where you guys start new developments as kind of the economics may not make sense in some of the more expensive

land markets?

Phil Hawkins
Certainly land prices have moved. I'd say they're moving still, but it's probably decelerating in terms of rate of growth. The yields have come down. We're focusing on land, though, that isn't cold marketed as much as, we're trying to find land that we can assemble or has wet, there are some sites that we have under contract now we're working through the various commissions that are appropriate for the state and local areas on wetlands and mitigating that and even some area, some land that has environmental issues that can be solved and fully claimed. And you've got to keep digging harder. It's where on the ground development and land expertise matters rather than buying somebody else's forward commit or ready to go land site, which, clearly, is a very much of interest to the institutional owner and developer. I don't think it should influence where we develop. It may make it harder to develop. We should not move to easier to develop higher return locations on paper, because I don't think that's the right decision long-term. We should be focusing on sites that we like long-term, infill in nature, major markets, not talk ourselves into a mediocre site at mediocre economics. I'd rather, frankly, sacrifice economics relative to our historical past than sacrifice location and land quality.

Blaine Heck
Okay, great. Thanks guys.

Matt Murphy
Thank you.

Operator
Our next question is from Tom Lesnick with Capital One. Please go ahead.

Tom Lesnick
Hey guys, good morning. Most of my questions have been answered at this point, but just a quick one, given where same-store NOI is year-to-date, could you talk a little bit about how you expect comps to trend directionally over the next few quarters, whether you're going to see tougher comps, softer comps in particular quarters, anything like that?

Matt Murphy
Well, I think, clearly easier than Q2, as I've said. I think there's, it was a number of things that sort of piled on to make Q2 tough. I think occupancies, frankly, have been relatively stable. So from an occupancy comp perspective, I don't feel like it changes a whole lot going forward. We obviously have talked about the fact that the numbers themselves are looking very good for the back half of the year, which is, frankly, a driven a little bit by occupancy, mostly driven by rental rate, which is, I talked about that, the increase of the actual contribution of cash NOI growth that were year-over-year rollovers, that's a number that just is, you're just starting to show its head, if you will, in Q2 and that will continue to drive momentum, going forward. The other thing it's easy to lose sight of when you start talking about rent bumps is you think about it when you are modeling it and just think about it logically that you're going to see, if you're going to have 3% rent bumps, it's going to be 3% every quarter. Well, what happens is those happened in given quarters and it ends up being lumpier. California, you all have heard me talk about this before, which is it's changing a little bit, but predominantly had been, let's say, it was a 3% annualized bump that you agreed to, what happened is you would get a 3% annualized bump, all of it would occur in month 30 of the lease and so that ends up being lumpy. So I think what you're going to see is that's a big part of the reason why the numbers get better on the back half of the year, are both of those factors. And I guess I don't really feel like, unlike last year where you could

just see everything pointing towards a Q2 having a sort of aberrant point of comparison, it seems a lot more, I don't know, consistent going forward. Obviously, as we get into '17, I got to know how the remainder of '16 played out with more certainty to answer that question beyond '16, but that's kind of the way it feels to me.

Phil Hawkins
And we will, to the extent when we issue '17 guidance and we see any anomalies, [multiple voices] as Matt did last quarter, we will continue to try to call them out without issuing quarterly guidance, but we want to be as transparent and helpful as possible within sort of the guidelines and the constraints that we're given.

Tom Lesnick
No, I appreciate that and just one follow-up, actually, obviously, your Amazon exposure has grown and you guys probably have better insight into what they are doing from a real estate perspective than a lot of companies out there. But what are you guys seeing in terms of the TI packages they're investing into real estate right now? I mean, aside from what you guys are investing, are you seeing them really scale up the amount invested in buildings or is it kind of, I mean, been the same over the last couple of years?

Phil Hawkins
Hey, Mike, why don't you, Mike's probably got the most active relationship with Amazon. Why don't you offer whatever insight you're comfortable sharing about that?

Mike Ruen
Sure, from our perspective, we participate in just a portion of what has become their, call it, 60 million square foot infrastructure and where you are seeing more investment in TI is an area where we're not as dominant a player. Again, with an infill strategy, we have an opportunity to work with them with respect to regional facilities on the fulfillment side and then, obviously, some of their more smaller initiatives which are, they're very active in with respect to last mile on their Omni channel initiatives. Where you see the high level of investment are in more of the super regional facilities. For example, they have 5 facilities underway today that are 44 clear, three levels of structural mezz, etcetera. We are not players in that world. So although we keep a close eye on what they're doing because they are such a bellwether for other groups that are following suit on the fulfillment side, that's not an area that we're really exposed to. So the deals that we have done with Amazon have been more traditional levels of TI and/or in certain instances where they do have a little bit more capital, we will analyze whether or not we want to make that investment at a higher return.

Tom Lesnick
No, I appreciate that insight. Thanks, again.

Mike Ruen
Yeah, sure.

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

Mitch Germain
Good morning, guys. Matt, you referenced the small tenant leasing, industry background, is that really diverse, is there any sort of theme you can get from those customers?

Matt Murphy
No, it's one of the hard things about smaller tenants is they do tend to be a little bit more homogenous or diversified. I think really the 3PL business has picked up, certainly. They tend to be in a little bit bigger spaces, but they cross the spectrum.

Phil Hawkins
One thing I've heard, I think construction-related, construction building, commercial building, electrical supply, lighting supply, that kind of stuff, I've heard from a number of our market leaders tends to be more of a trend right now than it might have been a year ago.

Matt Murphy
Yeah, clearly more and that's a really good observation because those are the guys that'll be a 25,000 square foot tile guy or a 40,000 square foot granite guy and that is picking up, still probably not back to where it was in 2007, but it is definitely lending to the momentum.

Mitch Germain
Great, that's helpful and maybe just a broader question, Phil, Matt, as well, yeah, I know institutional investors have been long underway industrial real estate and I'm curious where they stand today, maybe relative to historical levels? Have you seen that pickup, that rise in holding amongst that subsector?

Phil Hawkins
Certainly, from what I hear from investment brokers and what we see as we both compete for assets as well as sell assets, is they're certainly behaving like they would like to increase their exposure to industrial real estate. Pension funds, particularly, but results, but even dedicated industrial distribution type funds are raising money primarily from pension funds, as well. There's nothing in the capital environment that we see that indicates that appetite is being satiated at this point. It's, they've obviously liked the business, but they've liked it for a long time and it's not just a response to the current bull market environment. It's really a response to what they like about the asset long-term, the asset class long-term. It just continues to be rather impressive in terms of the amount of capital as it's looking to acquire good quality industrial real estate.

Mitch Germain
Thanks so much, guys.

Operator
Again, if you have a question, please press star (*) then one (1). Our next question is a follow-up from Eric Frankel with Green Street Advisors. Please go ahead.

Eric Frankel
Thank you. Perhaps this question is for Mike. Mike, in your respective markets, can you just talk about cap rates, overall asset values and how that trends in the last, or throughout the year?

Mike Ruen
Sure, I mean, obviously, the trend has certainly been down for cap rates and as we've talked before, our markets here on the East Coast lagged somewhat in this recovery, but we continue to see some compression, certainly in, actually, I think we're starting to slow. We're still seeing some compression in our major markets like Atlanta, Miami. But where we're seeing the most

movement now is in your second-tier markets. We're seeing some real pressure now on markets like Orlando and Baltimore and Nashville, markets that are a little bit later to the game but we find more capital seeking those yields. So we've actually seen a bit more compression in our second-tier markets this quarter.

Eric Frankel
Interesting, can you clarify where you think cap rates are in Atlanta at this point?

Mike Ruen
Yeah, I'd say Atlanta is a solid 5.25 to 5.5 market.

Eric Frankel
Okay.

Mike Ruen
And in some cases, again, and you have to be careful when you're generalizing, because we have certainly seen trades below right through 5, but they're unique situations, so I wouldn't want to put a blanket cap rate on Atlanta and say it's a sub-5 market, but we certainly have seen trade sub-5. So a little bit sub-5 on up to mid-5s for good A product.

Eric Frankel
Got it. Got it, got it. Final question, it relates to just development and your cost of capital. I know you've stated, especially in this call that, you're a little bit apprehensive to look at widely marketed deals to take advantage of, call it, whatever, disposition proceeds or equity, but any thoughts on working with developers who have land tied up? I know you've done that on a more opportunistic basis, but perhaps if you find something that you really like and the permitting process is complete, are you willing to maybe perhaps become a bit more of a takeout partner, especially given where your cost of capital is today?

Phil Hawkins
I think on an opportunistic basis, we have and we will continue to do so, by the very nature that means that they'll be fairly episodic and limited. And the one criteria I would have besides loving the real estate is we have absolute control over decision making. We, as you might remember or some of the people on this call remember, before we went public, that was the approach to development at DCT and we had some great partners and we also had some partners that were more difficult to work with. And the lesson learned there is one, control yourself, if at all possible. Create value to the land process, that's where that real money is made. You can create a lot of money through the land process and then lastly, you make sure you're in control because when things don't go as planned, you don't want to have a cumbersome decision making process to react to either the upside or the downside that you're looking at.

Eric Frankel
Okay, thanks for the color.

Operator
There are no further questions so this will conclude our question and answer session. I would now like to turn the conference back over to President and CEO, Phil Hawkins, for any closing remarks.

CONCLUSION

Phil Hawkins
Well, thanks, everyone, for joining our call today. We appreciate your interest in DCT and look forward to talking again next quarter, if not sooner. Enjoy the rest of your summer. Take care.

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