DCT Industrial Trust, Inc.

3rd Quarter 2017 Earnings

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CORPORATE PARTICIPANTS

Melissa Sachs - Vice *President, Investor Relations*

Phil Hawkins - *President and Chief Executive Officer*

Matt Murphy - *Chief Financial Officer*

Mike Ruen - *Managing Director, DCT's East Region*

PRESENTATION

Operator
Good day, and welcome to the DCT Industrial third quarter 2017 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 touchtone phone, and to withdraw your question, please press star then two. We ask that you please limit yourself to one question and a follow-up. Please note today's event is being recorded.

I would now like to turn the conference over to Melissa Sachs, Vice President, Investor Relations. Please go ahead.

Melissa Sachs
Thank you. Hello, everyone, and thank you for joining DCT Industrial Trust's third quarter 2017 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 updates to guidance. Additionally, Mike Ruen, our managing director of DCT's East Region will be available to answer questions about the market, development, and other real estate activities.

Before I turn the call over to Phil, I would like to remind everyone that management's remarks on today's call will include forward-looking statements within the meaning of Federal Securities Laws. This includes, without 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. Reconciliation of these non-GAAP financial measures are available on our supplemental, which can be found in the Investor Relations section of our website at dctindustrial.com.

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

Phil Hawkins
Good morning, everyone, and thanks for joining our call today. We are thrilled to report another strong quarter of operating and financial performance. DCT is fortunate to be in a very dynamic business with an organization, operating portfolio, and development pipeline that position us well to continue delivering top-tier results and value creation.

Tenant demand remains strong with significant upward pressure on rents driven by historically low vacancy rates and rational levels of new supply. Occupancy in our operating portfolio ended the quarter at 98%, a level that was unimaginable a few years ago but speaks to the strength of our business as well as the quality of our assets and their locations. This very favorable leasing environment is reflected in our rent spreads on signed leases of 24% on a straight-line basis and 10% on a cash basis.

Based on the quarter's strong results as well as our confidence in market fundamentals, we increased guidance for FFO per share and same-store NOI growth, which Matt will discuss in more detail shortly. We also increased our quarterly dividends 16% as we look to maintain our payout ratio at the minimum level required by REIT laws.

Leasing in DCT's development pipeline is on if not ahead of schedule, and it ramped typically more favorable than our initial underwriting. As with our operating portfolio, we are more focused on rents and tenant quality than speed of lease up. The current development pipeline has a projected yield of 7.2% and an average estimated value creation margin of 43%, representing a very attractive risk-adjusted return on capital.

In addition to executing ahead of plan on our current development pipeline, our market teams continue to demonstrate their ability to source new opportunities. While the market for great development sites is competitive, our teams leverage their knowledge and relationships to identify infill land sites that others may have overlooked because of challenges associated with zoning, entitlements, wetlands or environmental issues, or existing structures that need to be addressed.

To successfully execute our strategy to develop the very best infill sites in our market, we are willing to invest our time and our capital to solve these problems, creating substantial value to the process rather than simply buying ready-to-go land, which typically delivers lower returns and value creation margins. In short, we have the ability, patience, and commitment to take on the difficult and time-consuming projects, which allow us the source excellent locations and deliver higher returns.

As I mentioned last quarter, we put several packages of assets on the market to fund our development pipeline and maintain balance sheet capacity. They have all progressed to the contract and due diligence stage with closing expected this quarter or, for tax purposes, early next year. Investor interest in the packages have been strong and pricing has surprised to the upside. I believe that, given current pricing, selling assets rather than issuing equity is a preferred source of capital that allows us to continually enhance portfolio quality and future per-share growth potential as we redeploy that capital in the new, higher-returning development with excellent returns.

With that, let me now turn it over to Matt.

Matt Murphy
Thanks, Phil, and good morning, everyone.

The third quarter was yet another reminder of the strength of our business at DCT. Our occupancy, rent growth, leasing, and NOI growth reflect a business and organization that are very well-positioned to take advantage of current and future trends in today's logistics world. I will go through some of the details for the quarter and talk about guidance for the balance of the year.

From an operating standpoint, same-store NOI growth continues to be a highlight for DCT. For the quarter, cash same-store NOI grew 10.9% in our quarterly same-store portfolio, well ahead of expectations. This number was enhanced by free rent declining $3.4 million in 2017 versus 2016 and same-store average occupancy increasing 50 basis points to 97.9%.

As I've said before, the benefits of the burn-off of free rent in this portfolio will likely moderate significantly going forward, and it's hard to imagine that we enjoy further increases in occupancy. However, even without these components, cash same-store NOI growth would have been 5.3% for the quarter. These very positive results built on the foundation of improving rent bumps and very strong re-leasing spreads is as good a testament to the strength of our business and our portfolio as I can think of.

Another example of the strength and resilience of our business comes from an unlikely source. We experienced several early terminations in the third quarter. In some cases, these were the results of actual or impending bankruptcies, and in some cases, they were orchestrated by our market teams as they constantly look for ways to either unlock the potential of below-market leases and/or replace tenants that aren't as likely to remain in the space beyond their maturities.

In total, we got back approximately 450,000 square feet of space related to these early terminations. The bad news is that these events cost us approximately $900,000 this quarter in NOI and FFO as the result of bad debt, lost rent, and the write-off of straight-line receivables of which approximately $600,000 impacted same-store NOI. The very good news is that approximately 350,000 square feet or almost 80% has already been released and have positive re-leasing spreads of almost 40% on a straight-line basis and almost 25% on a cash basis, which will be very beneficial to growth going forward. I think this is an excellent indication of both how little high-quality space is available in our markets today as well as the creativity our teams exhibit in their pursuit to optimize and accelerate growth.

Before turning to guidance, I want to point out a typo that was discovered in our press release. In the second sentence of the property results and leasing activities sections on page one, we mistakenly wrote that the impact of acquisitions, dispositions and placing developments and redevelopments in service increased occupancy by 30 basis points when, in fact, the impact actually decreased occupancy by 30 basis points. None of the actual occupancy numbers were incorrect. I apologize for any confusion.

With respect to guidance, we are increasing and narrowing our 2017 FFO guidance as adjusted to between $2.44 and $2.46 per share, an increase of $0.03 at the midpoint. This increase is the result of better than expected operating results, changes in the expected timing of dispositions, and a delay in the issuance of long-term debt, each of which I will discuss in a moment.

From an operating perspective, we are increasing and narrowing our expectations for 2017 average operating occupancy to between 97.25% and 97.75%. We are also increasing and narrowing our expectations for cash same-store NOI growth to between 7.5% and 8.0%. With respect to capital deployment, we are increasing and narrowing our projections for development starts to between $300 million to $350 million and setting our projections for acquisitions to $82 million, the amount we have already closed this year. While our teams continue to look for transactions that will be accretive to our portfolio quality and growth prospects, our guidance does not contemplate any incremental transactions.

With respect to dispositions, we are increasing and narrowing our guidance to between $200 million and $225 million, much of which we expect to close very late in the year. In fact, the closings of some of these assets may be pushed into very early 2018 for tax reasons. The combination of more and later dispositions, lower acquisitions, and somewhat slower development expenditures on the back half of 2017 has resulted in us delaying the execution of our next debt transaction into 2018.

We began 2017 with an optimistic outlook about our business and with high expectations for financial results at DCT. This has proven to be well-founded and even a little understated as our company and our industry continue to establish new heights in terms of occupancy and rental rates. As we prepare to turn the page into 2018, we continue to have a positive outlook based primarily on the continued strength of tenant demand, in general, and with the behavior of our own tenants who are showing their commitment to their distribution networks through their own investment and actions.

It's becoming abundantly clear that more and more companies are viewing their distribution facilities as a critical element of their strategic success as opposed to an unavoidable cost of doing business. We believe that this is a trend that is, in many ways, just starting to take shape and that bodes very well for the future.

Let me now turn it over to Rocco for questions. Thank you.

QUESTION AND ANSWER

Operator
Thank you, sir.

We will now begin the question and answer session. To ask a question, you may press star then one on your touchtone phone. If you are using a speakerphone, we ask you to please pick up your handset before pressing the keys. If at any time your question has been addressed and you would like to withdraw your question, please press star then two. Please also limit yourself to one question and one follow-up.

At this time, we will pause momentarily to assemble our roster.

And today's first question comes from Jaime Feldman of Bank of America - Merrill Lynch. Please go ahead.

Jaime Feldman
Thanks and good morning.

Matt, I want to go back to your last comment about it being abundantly clear that companies are viewing their distribution network as key assets. Can you just give more color on how different it really feels today than maybe earlier this cycle or even the beginning of last year?

Matt Murphy
I think it manifests itself in a number of ways. I think, one, you're seeing companies really invest a lot of capital into their own spaces, really enhancing the efficiency of their operations. I think the other one that feels pretty apparent to me, and we've talked about it, frankly, a number of quarters in a row, is that people are no longer choosing their facilities based on their cost. They're choosing it based on their ability to positively impact their operations. And I really do feel like it feels like a monumental shift from five years ago, and it feels like something that is happening at an increasing rate, if you will, even over the relatively short-term.

So, like I said, it manifests itself differently in every customer. But, there's a lot of common themes, and they are becoming more and more prevalent.

Jaime Feldman
And then, for my follow-up, Phil, you were talking about you guys are willing to do the work to find land that maybe others can't get ahold of or can't put into service. As you think about your development starts in '17 and you think about your land bank as it sits today and the demand profile that sits today, do you think you could have more starts in '18, or there's just not enough land to do it?

Phil Hawkins
We've got a pipeline that could generate start activity consistent with '17 plus and minus. The question becomes can we get it through the approval process quick enough, and will there be leasing in some other adjacent site? Sometimes, we have a two-building site. Will leasing go according to plan or faster, and then will the approval process go according to plan or faster?

We've said this many quarters in a row. The approval process takes longer, and it's taken us longer than we've expected in more and more cases. But, that's a positive in the sense that that's also applying to everybody else as well.

I think '18 sets up to look similar to '17, in general, though.

Operator
And our next question today comes from Manny Korchman of Citi. Please go ahead.

Manny Korchman
Good morning, guys. Phil, maybe one for you, as this space remains strong and as acquisitions become more difficult, do you get more aggressive in your underwriting and try to go outside of where you felt comfortable in the past to make deals happen?

Phil Hawkins
Price levels per foot at these current levels would have made me very uncomfortable five years ago. But, the underwriting itself relative to current market rents, fairly conservative estimates of growth on those rents, will be proven to be too conservative, actually, looking backwards. In estimation of residual cap rates, I think we are viewed to be, by many brokers, on the more conservative side of that.

What has changed in our thinking has been growth of income from growing rents is much more dramatic than it was five years ago and much more of a driver in how we think about assets. The Anaheim asset we bought this quarter is a great example where it's a for-lease building. But, in about a year, the lease in place rolls and it is 15% below market. we get at a fairly quickly below-market rent as opposed to waiting three or four or five years where you have to hope that your view of the future holds, which does give us really good growth; strong IRRs, assuming some level of residual cap rate that's reasonable; and an asset that, while we are not stealing it from a price per foot, is Class A, new, irreplaceable in an infill location in a market that's less than 1.0% vacant.

To me, that is a great example or prototype of what we like. We've love to do more of those. The problem is that that's the hard part.

Manny Korchman
And then, maybe just switching to tenants for a second, you mentioned that cost is less of a factor. Is that true across different industries and user types? And, if so, how hard do you look

at really pushing an in-place tenant's rent to where a different industry might be paying it rather than a similar asset in the market if that question makes sense?

Phil Hawkins
I'm going to answer it. It's really on a space-by-space, case-by-case, tenant-by-tenant basis as opposed to industry generality. But, for the most part, I'd say it's across the board demand from traditional users of distribution space, not just e-commerce, are less price-sensitive and more location and function-sensitive.

Having said that, a lot of the supply increase that we've seen in the number from CoStar and others comes from what I would describe as commodity locations - South Dallas, South Atlanta, North Atlanta, far-West Chicago, even Empire East. Clearly, there are tenants that view the trade-off between location and cost differently. But, the preponderance of users across industries are much more location and function sensitive and less price sensitive, which is why, when Matt talked about buying tenants out, that's exactly what we're trying to do, or when I say we're trying to be more patient with respect to focusing on tenant quality and rent than speed, because that first lease-up of a development project or the next lease-up in an existing asset is critical to set you up for renewal. And maybe that renewal comes at a time when there aren't as many tenants out there and you're not as indifferent about renew or relet.

Again, it comes right down to that it's an on-the-ground decision based on knowledge of the tenant, knowledge of the building, and more importantly, knowledge of our competitors to push rents.

Operator
And our next question comes from Craig Mailman from KeyBanc Capital Markets. Please go ahead.

Craig Mailman
Good morning, guys. Matt, maybe for you, on the sustainability of rent spreads here, they continue to be really strong. In the past, you've talked about trough rents versus post-trough rents and the breakdown there. Could you run through whether any of this is being skewed by pre-recession or early post-recession leases coming due?

And then, also on that point, your expiration schedule for '18 is a little bit light in terms of what you guys can get at. You talked about taking back some space through early terminations. Maybe give us a sense of what percent of the portfolio you think you could roll in '18 to get at these spreads.

Matt Murphy
Hopefully, I'll get to all of that. Remind me if I don't.

The term I use to talk about your first question, which is lease vintage, which is about when was the previous lease signed. I think about it as pre-recession, during recession, and post-recession. And, quite honestly, for a while, I shared the view that the really needy re-leasing spreads were going to be the function of the ones that were compared against the leases that were signed when we were pretty darned defensive during the trough. And that clearly was true as the recovery was gaining legs.

I think what's been very encouraging to me when I look at third quarter numbers, and I'm going to make the same caveat I always do when you're talking about re-leasing spreads, they tend to be more volatile because they were very, very transaction-specific. But, for the first time that I've noticed while I've been looking at this, the post-recession re-leasing spreads were actually very slightly better than the during-the-trough re-leasing spreads were. They were both in the 24s, so they were very similar. I think what you're seeing is market rent growth that's going on, both for the last couple of years and is happening currently, is now starting to catch up to the comparisons of the very low rents we did.

I do think that dynamic is changing. I think it's reflective of the current market that, based on the lack of available space we've had today, based on all the topics we talked about, you are seeing market rent growth being very strong today. I don't think the party is over with regards to re-leasing spreads. I'm not going to break tradition and start predicting what I think they're going to be for any given period of time, but I do believe that there is, assuming that tenant demand stays in the same basic format it is today, still quite a bit of legs to that phenomenon.

The other comment that you asked there, at least, that I remember was with regards to a relatively small amount of space that's still to roll in 2018. And, while that's true and we have about 10% of square footage that's going to roll in '18 on top of about 1% that's left in '17, it's really only up a little short of 9% in terms of annualized base rent.

The other thing to keep in mind is that part of the reason that number's as low as it is is because we've addressed a lot of maturities that already happened. We re-leased those spaces in 2017. There's about a little less than 2.5 million square feet of leases that have already been renewed but have not commenced. The roll is about 14% that will have happened by the time we're done with the year. In this market, you almost wish you'd have 30% rolling. Our business doesn't play out that way, and I'm sure I don't really mean that.

And with regards to how can we manufacturer expirations, which I think was the last part of your question; I went through some examples of how it can happen. It's a difficult thing to predict because it needs to be the confluence of varying things. I'm not going to put a number to that because I wouldn't know how, but I'm quite confident that some of it will happen. And so, again, I think that bodes well. It's a great spot to be where you're not only not afraid of expirations but, in some case, you're actively pursuing it. I think that's just a tremendous indication of the way our business is today.

Craig Mailman
That's helpful, and I'll maybe slip in a follow-up separately on dispositions. Some of this may be addressed in the packages you guys have coming, but just looking at the portfolio, you have a few markets where you have less than a million square feet. How do you view cleaning up the portfolio or cleaning up markets here as you go forward, take advantage of pricing, and maybe calling some markets where you have bigger exposure that the growth, long-term, may not be as high as some of your coastal exposure?

Phil Hawkins
For the most part, our sales process is focused on asset selection as opposed to market selection. We sold a building in Northern California. We sold out of Louisville. I think you'll see us exit a couple other markets over the next 12 months including two markets in one of the packages that we have out there now. It's in due diligence, under contract, and nearing the end of the due diligence process. Then, you'll see us exit two more markets.

We've said before I'd prefer not to be in markets that are impacted by tax abatements, property tax abatements that incent new supply and may put the current landlords or current owners at a disadvantage relative to rent growth and NOI growth. That thinking, from a market perspective, will apply. But, for the most part, it's asset by asset.

And, while we've made tremendous progress on our portfolio repositioning, I think 70% or more of our assets today didn't exist at the IPO, which is, to me, a pretty remarkable stat, it never ends because assets get older every year. We execute strategies that may maximize value in our view and result in lower growth going forward. Markets change. Some markets change, and we need to continually upgrade our portfolio to maintain the company's vitality.

Operator
And our next question comes from John Guinee of Stifel. Please go ahead.

John Guinee
Thank you very much. Phil, if you think about what it is costing you to develop versus this time last year, talk a little bit about how much land has gone up and how much hard costs have gone up in your key markets.

Phil Hawkins
Do you know what? Since Mike dialed in, I'm going to give Mike Ruen a chance to answer the question. I can follow up with it as well.

Mike, do you want to start?

Mike Ruen
Sure. Overall, John, we've seen hard costs of construction stabilize a bit. Commodities are now flat. Some of the spikes that we were seeing are in contract or margins, and spikes in labor seemed to have leveled off. When you look at just construction costs across the country, we're comfortable and feel it's more predictable today. And we're using a range of about 3% to 5% overall.

The wildcard, as always, is the land, not only finding the land that supports our strategy but the cost and the site work that goes with it. We've seen probably something closer to 10% to 15% pop in land over the last 12 months.

Operator
And our next question today comes from Eric Frankel of Green Street Advisors. Please go ahead.

Eric Frankel
Given the substantial investor interest in this sector, there's a couple large portfolios coming in on the market. Can you talk about your criteria for whether you'd consider a larger investment?

Phil Hawkins
It starts with what our strategy is today, which is market focus, focus on markets that we believe have higher than average growth relative to the national averages, portfolio quality is very important, and then location within those markets, sub-markets that we consider to be good long-term growth opportunities rather than some commodity location where we'll see less rent growth and be less protected as a long-term owner. We'd apply that to any particular portfolio.

And portfolios of that size tend to be somewhat eclectic. As you pointed out, actually, in your note last night, I think your note was right. They're fairly eclectic and probably not well-suited for

DCT strategy. For us to go take down a large portfolio and the financing risk that brings on to then have to sort through and keep half or less than half is a pretty inefficient way to acquire assets, particularly when you have portfolio premiums in this environment that are probably 5% or more. It's expensive to acquire a portfolio like that.

Eric Frankel
Okay, I'll jump back in the queue with just a quick follow-up. One market I noticed there's a lot of lease roll next year is Cincinnati. Matt, maybe you can just discuss your portfolio that you have rolling there and your prospects for re-leasing that space.

Matt Murphy
Yeah, I think you're right. It's a factual answer. Cincinnati does have a lot of roll next year. The only known move-out I know, we've got basically 225,000 square feet that rolls. I believe it's in October. I think it's October 31, so it actually rolls in November. We're pretty sure we're getting that space back.

Beyond that, I think the team really likes the assets that we have that are the space that's coming due. The market is very tight, particularly for high-quality space. There's the Kentucky, Cincinnati. It's not a homogenous market, and I think we really like the space that we have, in general. But, it's specifically the space that we're getting back.

There's a lot of work to do. We've got a team that I think is ready for it and a market that's going to be receptive to it. Like I said, they do have the largest known move-out that I know of in our portfolio. But, all in all, I think it's a good time to be getting space in Cincinnati if it's ever a good time to get space.

Operator
And our next question comes from Blaine Heck of Wells Fargo. Please go ahead.

Blaine Heck
Good morning, guys. Just following up on John's earlier question, how do you think about the effect of rising construction costs on yields just as we think about your recent starts and looking forward into 2018?

Phil Hawkins
Well, they're certainly baked into our projections, and it's one of the benefits of having tied up land. Most if not all of our 18 starts will be on land we control today. And so, as a result, we've got visibility.

Certainly, construction costs continue to move up. But, as Mike said, they're fairly well-stabilized at this point, somewhat predictable. We have fairly conservative contingencies as well for cost increases due to either prices or to encountering unexpected issues in the development process itself.

To me as an owner, and we're a far bigger owner than we are a developer, it lifts the ceiling for rent growth, which is a significant positive. As you need to develop new space to meet current demand, the cost of meeting that marginal demand is going up 5%-8%, 10% if you're procuring land. And that is a very good thing for an owner of real estate.

Blaine Heck
And then it looks like the implied same-store NOI guidance for the fourth quarter is in the 4% to 5% range. Matt, as you said, you guys are probably not going to see much benefit from occupancy growth at this point. But, do you think that 4% to 5% growth is sustainable going forward given what you're seeing on the rent growth side?

Matt Murphy
Yeah, honestly, I do. First of all, your math is right, as it usually is, and I think it's probably a little bit higher than it looks because I know what the fourth quarter of '16 was and you don't. I think we will actually face a little bit of occupancy where, potentially, the midpoint of guidance would imply occupancy tailwinds in the fourth quarter.

I keep coming back to we are getting to the point where our average bump is pretty generally above 3%. And, if you assume a static occupancy, which I'm not saying you should or shouldn't, but if you assume a static occupancy, what really is left is re-leasing spreads. And, given what we've talked about, obviously, we're talking about cash here, and it seems like a pretty reasonable starting point given short-term periods may ebb and flow from that for mixed reasons.

One of the things that is confounding when you try and compare modeling to the real world is we tend to think of bumps as happening homogenously during the year. They don't. They happen at, generally, the one-year anniversary of the last bump or the beginning the lease. I think that's a pretty good logical starting point.

Operator
And our next question today comes from Rob Simone of Evercore ISI. Please go ahead.

Rob Simone
Thanks for taking the question. I just wanted to see if you guys could comment on a theme we've been hearing and that theme being that, given the cost of land and rising construction costs and the relative inability of land, there's actually an "unhealthy" level of supply out there.

It's great for landlords like you guys that have boxes in the air because you're driving this crazy pricing power, but have you guys thought at all about what the second-order effects could be down the road from an unhealthy supply environment? I'm just wondering your general thoughts on that.

Phil Hawkins
You think it's unhealthy in that there's too little supply being built?

Rob Simone
Yeah, that's right. The tenant demand is so far outpacing the amount of supply that can be built on institutional quality and located area. It's more unhealthy from a tenant's perspective right now, but are there any second-order effects that could trip you guys up at some point if at all?

Phil Hawkins
I don't think it's a negative at all. In fact, you see supply is fairly healthy spoken to demand in many of our markets. Low vacancy rates and the cost of that in supply is what is driving the rents. It isn't a relatively lack of supply itself. It's not oversupplied, but I don't describe it as dramatically undersupplied either.

To me, what's driving rents is tenant choices. There's plenty of supply in commodity location in every major market we're in. And they can be larger building as well, but the lease-up of those buildings is slower despite rents being lower than more infill locations. And, to me, that says not that there's some second derivative coming or that it's unhealthy but that there's been a significant change in tenant behavior that we've been talking about for, now, some time and have built our strategy around, which is if they need to be closer to the urban core, closer to their customers.

And that is what's driving rent increases because of the cost of that supply. The land itself is more expensive. The entitlement's more expensive. It's more timely. It takes more time. And there's less of it. Of course, there's a constraint on supply in non-commodity location which is very real. But, it's a natural outgrowth of where tenants want to be. They want to be in places that industrial hasn't necessarily been before or it's very old industrial product that needs to be redone, and it just takes time, and it's expensive.

I'd love to see supply even lower, and I wouldn't be worried at all about the negative consequences of that outcome.

Rob Simone
And then just one quick follow-up, another thing that we've heard is that it's getting to a point that some tenants, and big, global tenants that are in many different geographies both domestic and international, are almost at the point where they're completely agnostic to pricing, which is, again, great for you guys. But, just in terms of tenants' cost of distribution facilities within their supply chain, is there a limit to that? Do you guys have a view on how much upside there could be on that percentage of total cost before the tenants do care again about pricing?

Phil Hawkins
I think some people have gotten carried away. I've not met a tenant who's agnostic on pricing in any way, either by the way they behave or the way they talk. I think I said last call that these are professional negotiators that are very focused on cost. We're making trade-offs. You need to understand what they're looking for and not necessarily say yes too quickly.

But, they're not agnostic. They're very cost-conscious. They just are not willing to go to lower-cost submarkets or lower-cost product because the performance of that product relative to their supply chain needs or objectives would be less performance.

Like I said, we're never going to be in a world where we just have a named price. That just doesn't exist.

Operator
And our next question today comes from Ki Bin Kim of SunTrust. Please go ahead.

Ki Bin Kim
Good morning, guys. Going back to the lease expiration questions, if I look back about a year ago in your previous year supplemental regarding the leases set to expire this year, their average rent was about $4.28. And then, if I look at the supplemental this year, what's going to expire for next year is about $4.84. I know there's a market mix change, obviously, this year. In 2017, you had more Southern California, Orlando, Memphis, and Chicago expiring, and next year, like Eric said, was more Cincinnati, less Southern California.

Obviously, a mix change maybe vintage change, but I'm just curious. Given those numbers, do you think the lease spreads that you've been achieving so far are achievable next year?

Matt Murphy
Again, as I said, I don't like to try and predict lease spreads for any period of time. I think mix always matters.

The way I hear you, you've mixed two concepts. One is re-leasing spreads, and one is average rent. The average rent of leases that are done in any given time is hugely dependent on not only geography but space size, percent of build-out, etc. To me, I don't ever try and think in terms of average rent because that's so determined by the individual space we're talking about.

I think in terms of re-leasing spreads, I'll go back to what I said a minute ago, which is current market rents are growing at very healthy paces to really, really healthy paces, and there is some distinction between markets. And I think the variability associated with the comparison lease, the old lease, is getting less and less pronounced as we get further away from the recession. I think the trends are positive.

I don't want to try and compare the actual end result in '17 versus a predicted result in '18. I won't even do that 90 days from now when we're actually giving guidance for '18. I think the environment is very healthy.

Ki Bin Kim
And a follow-up question on the land that you're buying, can you help me better understand additional yield that you can basically earn from taking more of the risk from beginning to end when the fight is ready? And, on the flip side, is there actually any downside from buying more challenging land?

Phil Hawkins
Yeah, I'll take that. I'll give you one example. PetroPort, which is the land site we acquired this quarter in Houston, not surprisingly, but given the name, is the port submarket of Houston. You don't think of Houston being all that difficult from a land. There's no zoning. So, you think what's the big deal?

That site took Justin and his team 19 months, once we had it under contract, to work through entangled pipeline easements that were below ground, work with the seller on environmental issues, acquire small pieces that actually, at one point, were owned by all the subsidiaries of the seller, but the subsidiaries have been spun out, so that had to be consolidated. We had to bring utilities to the site. The result of that, when we tied it up and even now today, the land is 40% below what a developer would pay for it ready to go today. And that's not unusual.

Even in Houston, it's hard for us to compete on land ready to go when there's lots of capital chasing easy development. The benefit, obviously, is we get a pipeline of, from our view, better quality sites and better returns. The downside is twofold. One is that time, right now, has been a benefit. Rents have been growing. But, also, that could turn on us if the market ever turns. And the second downside is the cost that we're incurring to pursue those entitlements. While a lot cheaper than buying the land itself, there's pursuit costs that are involved that would be written off.

And the last biggest downside is, once in a while, we're unsuccessful. We've had a couple of sites, not huge pursuit dollars, where we just got to the end and lost. And that's always a nature of the business we're in. We don't expect to bat a thousand. We certainly try. But, that's the nature of our business is, if it was risky and easy, the returns we're seeing wouldn't be available to us.

Operator
And our next question comes from Bill Crow of Raymond James. Please go ahead.

Bill Crow
Good morning, everybody, two quick follow-ups. First of all, just curious, and maybe this is a question for Mike, but in the areas surrounding the hurricane-damaged cities, I wonder if there's any impact yet on construction costs, labor availability, etc., as the rebuilding effort takes place.

Mike Ruen
Well, there certainly is. We're certainly seeing a spike in costs. But, as you might imagine, it's limited to smaller one-off contractors that are able to go in and command a much higher price than they normally would for basic service. The impact to us and our peers with respect to commercial and industrial, it really has not because the brunt of the storm actually hit much further south in Miami, in the Keys, in particular, Islamorada and south of Big Pine. They got some real devastation. It's been very minimal as far as the overall impacts on construction.

I would add, though, that we were all extremely fortunate in the path of the storm in that it really missed us and came up the central part of the state. We did not have any flooding. And, in fact, there was not one insurance claim that impacted our portfolio. We were very fortunate.

Bill Crow
Second, the comment you made earlier, Phil, that you'd rather fund your development pipeline with asset sales than issuing equity, is that a statement on your part that private market valuations are still above public market valuations?

Phil Hawkins
No, not necessarily. I'm not going to argue that our overall stock price is below NAV. I do think, though, that the benefits of continually upgrading your portfolio were lessons everyone can learn from the past and something we've believed for the last ten years since we took the company public that you always needs to manage that portfolio.

That's not to say we won't issue equity. We have in the past. It's not an absolute yes or no on equity. We have a bias towards selling assets first as we get them leased and where we think maximizing value and growth relative to the future will sell those assets. And I'd much rather do that and sell individual assets than sell a small piece of the company via an equity issuance.

But, on the other hand, equity has its benefits. It's quicker, certainly less dilutive. But, we will continue to use both overtime with a strong bias towards asset sales because of the portfolio of quality benefits.

Operator
And our next question comes from Rich Anderson of Mizoho Securities. Please go ahead.

Rich Anderson
Earlier in the call, somebody identified the packages that are out there for potential sale are eclectic, and you agreed with that comment. Are your packages eclectic too, those that you're attempting to sell?

Phil Hawkins
Well, first, the last question was more about the billion+ portfolios that are out there. What we think sells best, from an execution perspective, are fairly homogenous portfolios where the markets are similar, assets are similar in quality, and therefore, in our view, maximize execution.

In one case, we did consolidate a package into a larger one. It's a $100 million plus or minus package. That was, in our view, to maximize price because there was some portfolio premium benefit because of the homogeny of it.

Yeah, we think we try to keep it focused. But, you get into those big packages and the buyers are thinking differently, and we are not a very effective buyer, I don't think, on billion-dollar portfolios. Even if they were willing to take stock, it's just not a good fit for DCT. There will be, I suspect, a lot of interest for those packages that have been talked about in various trade publications in rumor blogs. They just won't be a good fit for DCT.

Rich Anderson
I was just thinking in terms of how you're marketing your stuff with that observation in mind, and you answered the question. The second is now that you mentioned some of these BKs that have happened and you've been able to resolve a lot of that through re-leasing, I'm curious if there's a strategy that can be created around this.

Assuming a lot of this is bricks and mortar retailer-type tenants, do you think that there's a way for you to seek out these potential problems and orchestrate these opportunities for DCT? Or is that just taking on too much risk?

Phil Hawkins
We want to. This is Phil jumping in front of Matt. But, I think this is more of a strategic or conceptual comment.

We encourage our market teams to actively manage their tenant portfolio. And, if we've got opportunities in a strong market to upgrade rent and tenant quality proactively, we'd love to do it.

Rich Anderson
Let me just interrupt you. I'm meaning like you go out and buy something with the expressed intention of something potentially going wrong.

Phil Hawkins
We would have a value-add orientation however that might come forward, either in a tenant that's unlikely to renew or who would try to get out early. We've bought a number of buildings over the last couple of years where we saw the opportunity to eliminate the current tenant and re-lease it and with the downside being we let the lease expire and they move out. That's been one of many components we think about as we look for value-add opportunities in existing buildings.

I think that's something we're good at. We're not the only ones, but we're good at it. We've got people on the ground, aggressive, creator people, and it's one of a number of ways you can add value through existing assets.

Operator
And, ladies and gentlemen, as a reminder, if you'd like to ask a question, please press star then one at this time.

And it looks like our next question is a follow-up from Eric Frankel of Green Street Advisors. Please go ahead.

Eric Frankel
Matt, just to follow-up on the same-store calculations, can you share the differences between cash and GAAP same-store NOI growth excluding the free rent burn-off? I think it's the 5.3% against the 3.5% number.

Matt Murphy
Really, the primary difference is the only significant differences are straight-line rent, and that manifests itself both in free rent and in bumps. You can have a little bit of cash versus where you get to the writing off receivables. There can be a slight difference between what's a cash write-off and what's GAAP. But, really, those are the only differences, if I heard your question right, between GAAP and cash.

Eric Frankel
I think we asked this question in prior calls, but maybe you could address some of the construction delays it looks like occurred in the development portfolio in terms of when buildings will be completed.

Phil Hawkins
It's interesting. I almost jumped in when we were talking about cost because, when we were talking about the costs associated with the hurricanes costs, there's both costs you write checks for and costs associated with time. I think it's really remarkable to me.

Florida, in particular, you've seen a number of our buildings pushed back in Florida. That is entirely a function of the power crews. But, the crews and the transformers, the difficulty of getting those to the sites has had a meaningful impact on the timing for our assets in Florida. It also had an impact on our asset in Denver, although I don't think we actually pushed the date back because power wasn't the last piece in Denver. But, Public Service in Colorado sent half of their crews to the combination of Houston and South Florida to deal with those issues.

We had an interesting situation. I don't want to get into too much detail. In the stockyards project we had in Chicago where we had a water hookup, our plan was approved with the hookup in one place. And then, when it came time to actually hook up, the water company said, well, you can't hook up there. And so there was a long negotiation. It's one we could've solved the problem with cash had we wanted to. That's kind of a unique situation.

Our asset in Chicago, the FedEx facility at Central Avenue, getting the final change orders, touches on the work that they wanted us to do in the facility, I think, took longer than any of us thought. We had some weather issues at Arbor Road in Northern California. I think that's all of them that had any meaningful movement. I think that sums it up.

Eric Frankel
Mike, while you're on the call, maybe you can just give an update of the market conditions for the region that you cover. Obviously, Atlanta seems to have pretty healthy levels of both supply

and demand, but it looks like rents are up, at least in a lot of Sunbelt markets. They're up pretty big in Sunbelt markets, and maybe you can address that. Thanks.

Mike Ruen
Our markets are all really healthy. And your comment about Atlanta, in particular, Atlanta has really been strong the last three years, in particular, with absorption levels in the mid-teens. Right now, we're projecting net absorption in '17 will outpace '16.

The pockets where we're seeing some run-up in supply are, again, what Phil would call more commodity markets. We're not even operating in those submarkets, and that would be the far-out northeast I-85 quarter and the south I-75 quarter. However, if you look at the deal volume, we're not hearing about our peers or competitors worrying too much that do have stock in those submarkets.

But, for us, our strategy is infill. Even the large box that we have underway in Atlanta is close to an I-20 location. It's a big box, but its infill. But, overall, the markets are all really strong.

CONCLUSION

Operator
And this concludes our question and answer session. I'd like to turn the conference back over to Phil Hawkins for any closing remarks.

Phil Hawkins
Thanks, everyone, for joining our call today and your interest in DCT. We had a great quarter and hope to see many of you at Nareit in Dallas to talk more about that as well as our outlook for the future.

Take care, and if you have any questions, feel free to give Matt or me a call. Bye-bye.

Operator
Thank you, sir. Today's conference has now concluded, and we thank you all for attending today's presentation. You may now disconnect your lines and have a wonderful day.