Terreno Realty Corp
Form 10-Q
November 01, 2017
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended September 30, 2017

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from __________ to __________

Commission file number 001-34603

Terreno Realty Corporation

(Exact Name of Registrant as Specified in Its Charter)

Maryland	**27-1262675**
(State or Other Jurisdiction of Incorporation or Organization)	**(I.R.S. Employer Identification No.)**
101 Montgomery Street, Suite 200 San Francisco, CA	**94104**
(Address of Principal Executive Offices)	**(Zip Code)**

Registrant s telephone number, including area code: (415) 655-4580

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, smaller reporting company or an emerging growth company. See the definitions of large accelerated filer, accelerated filer, smaller reporting company and emerging growth company in Rule 12b-2 of the Exchange Act.

Large accelerated filer		Accelerated filer
Non-accelerated filer	(Do not check if a smaller reporting company)	Smaller reporting company
		Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

The registrant had 54,551,579 shares of its common stock, $0.01 par value per share, outstanding as of October 31, 2017.

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Terreno Realty Corporation

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements of Terreno Realty Corporation

Terreno Realty Corporation

Consolidated Balance Sheets

(in thousands except share and per share data)

ASSETS		*September 30, 2017 (Unaudited)*		*December 31, 2016*
Investments in real estate				
Land	$	693,316	$	570,181
Buildings and improvements		756,443		710,277
Intangible assets		70,407		62,580
Total investments in properties		1,520,166		1,343,038
Accumulated depreciation and amortization		(130,611)		(109,357)
Net investments in properties		1,389,555		1,233,681
Properties held for sale, net		6,050		
Net investments in real estate		1,395,605		1,233,681
Cash and cash equivalents		109,058		14,208
Restricted cash		4,265		4,270
Other assets, net		27,079		26,822
Total assets	$	1,536,007	$	1,278,981
LIABILITIES AND EQUITY				
Liabilities				
Credit facility	$		$	51,500
Term loans payable, net		148,827		148,616
Senior unsecured notes, net		247,880		148,594
Mortgage loans payable, net		65,264		66,617
Security deposits		10,494		9,922
Intangible liabilities, net		20,289		3,485
Dividends payable		12,005		9,483
Performance share awards payable		10,677		10,739
Accounts payable and other liabilities		22,387		18,220
Total liabilities		537,823		467,176
Commitments and contingencies (Note 11)				
Equity				
Stockholders equity				

Preferred stock: $0.01 par value, 100,000,000 shares authorized, and 0 and 1,840,000 shares (liquidation preference of $25.00 per share) issued and outstanding, respectively				46,000
Common stock: $0.01 par value, 400,000,000 shares authorized, and 54,569,238 and 47,414,365 shares issued and outstanding, respectively		546		474
Additional paid-in capital		992,570		766,229
Retained earnings		6,148		
Accumulated other comprehensive loss		(1,080)		(898)
Total stockholders equity		998,184		811,805
Total liabilities and equity	$	1,536,007	$	1,278,981

The accompanying condensed notes are an integral part of these consolidated financial statements.

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Terreno Realty Corporation

Consolidated Statements of Operations

(in thousands except share and per share data)

(Unaudited)

	For the Three Months Ended September 30,		*For the Nine Months Ended September 30,*	
	2017	*2016*	*2017*	*2016*
REVENUES				
Rental revenues	$ 26,452	$ 21,288	$ 76,629	$ 61,801
Tenant expense reimbursements	7,188	5,816	21,230	16,777
Total revenues	33,640	27,104	97,859	78,578
COSTS AND EXPENSES				
Property operating expenses	9,023	7,288	26,022	22,144
Depreciation and amortization	9,595	8,872	27,855	25,214
General and administrative	5,041	5,566	15,250	13,304
Acquisition costs		696	11	2,139
Total costs and expenses	23,659	22,422	69,138	62,801
OTHER INCOME (EXPENSE)				
Interest and other income	17		75	19
Interest expense, including amortization	(4,514)	(3,265)	(12,086)	(9,411)
Loss on extinguishment of debt		(239)		(239)
Gain on sales of real estate investments	15,449	1,892	25,549	7,140
Total other income and expenses	10,952	(1,612)	13,538	(2,491)
Net income	20,933	3,070	42,259	13,286
Redemption of preferred stock	(1,767)		(1,767)	
Preferred stock dividends	(178)	(891)	(1,961)	(2,674)
Net income, net of redemption of preferred stock and preferred stock dividends	18,988	2,179	38,531	10,612
Allocation to participating securities	(136)	(18)	(277)	(90)
Net income available to common stockholders, net of redemption of preferred stock and preferred stock dividends	$ 18,852	$ 2,161	$ 38,254	$ 10,522

EARNINGS PER COMMON SHARE BASIC AND DILUTED:				
Net income available to common stockholders, net of redemption of preferred stock and preferred stock dividends	$ 0.36	0.05	$ 0.76	$ 0.24
BASIC AND DILUTED WEIGHTED AVERAGE COMMON SHARES OUTSTANDING	52,804,611	45,762,761	50,277,432	44,204,965

The accompanying condensed notes are an integral part of these consolidated financial statements.

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Terreno Realty Corporation

Consolidated Statements of Comprehensive Income (Loss)

(in thousands)

(Unaudited)

	For the Three Months Ended September 30,		***For the Nine Months Ended September 30,***	
	2017	***2016***	***2017***	***2016***
Net income	$ 20,933	$ 3,070	$ 42,259	$ 13,286
Other comprehensive income (loss): cash flow hedge adjustment	8	4	(182)	(310)
Comprehensive income	$ 20,941	$ 3,074	$ 42,077	$ 12,976

The accompanying condensed notes are an integral part of these consolidated financial statements.

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Terreno Realty Corporation

Consolidated Statement of Equity

(in thousands except share data)

(Unaudited)

	Preferred Stock	Common Stock Number of Shares	Common Stock Amount	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Total
Balance as of December 31, 2016	$ 46,000	47,414,365	$ 474	$ 766,229	$	$ (898)	$ 811,805
Net income					42,259		42,259
Issuance of common stock, net of issuance costs of $3,673		7,248,992	72	226,355			226,427
Repurchase of common stock		(126,366)		(3,436)			(3,436)
Redemption of preferred stock	(46,000)			1,729	(1,767)		(46,038)
Issuance of restricted stock		32,247					
Stock-based compensation				1,693			1,693
Common stock dividends					(32,383)		(32,383)
Preferred stock dividends					(1,961)		(1,961)
Other comprehensive loss						(182)	(182)
Balance as of September 30, 2017	$	54,569,238	$ 546	$ 992,570	$ 6,148	$ (1,080)	$ 998,184

The accompanying condensed notes are an integral part of these consolidated financial statements.

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Terreno Realty Corporation

Consolidated Statements of Cash Flows

(in thousands)

(Unaudited)

	For the Nine Months Ended September 30,	
	2017	**2016**
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	$ 42,259	$ 13,286
Adjustments to reconcile net income to net cash provided by operating activities		
Straight-line rents	(2,865)	(3,124)
Amortization of lease intangibles	(1,521)	(992)
Depreciation and amortization	27,855	25,214
Loss on extinguishment of debt		239
Gain on sales of real estate investments	(25,549)	(7,140)
Deferred financing cost and mortgage premium amortization	866	508
Stock-based compensation	7,261	5,970
Changes in assets and liabilities		
Other assets	937	(1,960)
Accounts payable and other liabilities	4,408	5,153
Net cash provided by operating activities	53,651	37,154
CASH FLOWS FROM INVESTING ACTIVITIES		
Cash paid for property acquisitions	(190,108)	(84,016)
Proceeds from sales of real estate investments, net	64,183	21,379
Additions to construction in progress		(11,668)
Additions to buildings, improvements and leasing costs	(18,936)	(18,154)
Net cash used in investing activities	(144,861)	(92,459)
CASH FLOWS FROM FINANCING ACTIVITIES		
Issuance of common stock	224,469	72,711
Issuance costs on issuance of common stock	(3,295)	(1,088)
Repurchase of common stock	(3,436)	(1,551)
Repurchase of preferred stock	(46,000)	
Borrowings on credit facility	93,000	54,000
Payments on credit facility	(144,500)	(34,000)
Payments on term loans payable		(50,000)
Borrowings on senior unsecured notes	100,000	50,000
Payments on mortgage loans payable	(1,451)	(16,343)
Payment of deferred financing costs	(872)	(2,489)
Dividends paid to common stockholders	(29,861)	(23,900)
Dividends paid to preferred stockholders	(1,999)	(2,674)

Net cash provided by financing activities		186,055		44,666
Net increase (decrease) in cash and cash equivalents and restricted cash		94,845		(10,639)
Cash and cash equivalents and restricted cash at beginning of period		18,478		25,108
Cash and cash equivalents and restricted cash at end of period	$	113,323	$	14,469
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION				
Cash paid for interest, net of capitalized interest	$	10,917	$	9,059
Supplemental disclosures of non-cash transactions				
Accounts payable related to capital improvements	$	7,770	$	12,025
Redemption of preferred stock		1,729		
Reconciliation of cash paid for property acquisitions				
Acquisition of properties	$	209,738	$	86,038
Assumption of other assets and liabilities		(19,630)		(2,022)
Net cash paid for property acquisitions	$	190,108	$	84,016

The accompanying condensed notes are an integral part of these consolidated financial statements.

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Terreno Realty Corporation

Condensed Notes to Consolidated Financial Statements

(Unaudited)

Note 1. Organization

Terreno Realty Corporation (Terreno , and together with its subsidiaries, the Company) acquires, owns and operates industrial real estate in six major coastal U.S. markets: Los Angeles, Northern New Jersey/New York City, San Francisco Bay Area, Seattle, Miami, and Washington, D.C. All square feet, acres, occupancy and number of properties disclosed in these notes to the consolidated financial statements are unaudited. As of September 30, 2017, the Company owned 183 buildings (including one building held for sale) aggregating approximately 12.5 million square feet and eight improved land parcels consisting of approximately 41.6 acres.

The Company commenced operations upon completion of an initial public offering and a concurrent private placement of common stock purchased by the Company s executive management on February 16, 2010. The Company is an internally managed Maryland corporation and elected to be taxed as a real estate investment trust (REIT) under Sections 856 through 860 of the Internal Revenue Code of 1986, as amended (the Code), commencing with its taxable year ended December 31, 2010.

Note 2. Significant Accounting Policies

Basis of Presentation. The accompanying unaudited interim consolidated financial statements of the Company have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) for interim financial information and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, they do not include all of the information and disclosures required by GAAP for annual financial statements. In management s opinion, all adjustments (consisting of normal recurring adjustments) considered necessary for a fair presentation have been included. The interim consolidated financial statements include all of the Company s accounts and its subsidiaries and all intercompany balances and transactions have been eliminated in consolidation. The financial statements should be read in conjunction with the financial statements contained in the Company s 2016 Annual Report on Form 10-K and the notes thereto, which was filed with the Securities and Exchange Commission on February 8, 2017.

Use of Estimates. The preparation of the interim consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements. Actual results could differ from those estimates.

Capitalization of Costs. The Company capitalizes costs directly related to the redevelopment, renovation and expansion of its investment in real estate. Costs associated with such projects are capitalized as incurred. If the project is abandoned, these costs are expensed during the period in which the redevelopment or expansion project is abandoned. Costs considered for capitalization include, but are not limited to, construction costs, interest, real estate taxes and insurance, if appropriate. These costs are capitalized only during the period in which activities necessary to ready an asset for its intended use are in progress. In the event that the activities to ready the asset for its intended use are suspended, the capitalization period will cease until such activities are resumed. Costs incurred for maintaining and repairing properties, which do not extend their useful lives, are expensed as incurred.

Interest is capitalized based on actual capital expenditures from the period when redevelopment, renovation or expansion commences until the asset is ready for its intended use, at the weighted average borrowing rate during the period.

Investments in Real Estate. Investments in real estate, including tenant improvements, leasehold improvements and leasing costs, are stated at cost, less accumulated depreciation, unless circumstances indicate that the cost cannot be recovered, in which case, an adjustment to the carrying value of the property is made to reduce it to its estimated fair value. The Company also reviews the impact of above and below-market leases, in-place leases and lease origination costs for acquisitions and records an intangible asset or liability accordingly.

Impairment. Carrying values for financial reporting purposes are reviewed for impairment on a property-by-property basis whenever events or changes in circumstances indicate that the carrying value of a property may not be fully recoverable. Examples of such events or changes in circumstances may include classifying an asset to be held for sale,

changing the intended hold period or when an asset remains vacant significantly longer than expected. The intended use of an asset either held for sale or held for use can significantly impact how impairment is measured. If an asset is intended to be held for the long-term, the recoverability is based on the undiscounted future cash flows. If the asset carrying value is not supported on an undiscounted future cash flow basis, then the asset carrying value is measured against the lower of cost or the present value of expected cash flows over the expected hold period. An impairment charge to earnings is recognized for the excess of the asset s carrying value over the lower of cost or the present values of expected cash flows over the expected hold period. If an asset is intended to be sold, impairment is determined using the estimated fair value less costs to sell. The estimation of expected future net cash flows is inherently uncertain and relies on assumptions, among other things, regarding current and future economic and market conditions and the availability of capital. The Company determines the estimated fair values based on its assumptions regarding rental rates, lease-up and holding periods, as well as sales prices. When available, current market information is used to determine capitalization and rental growth rates. If available, current comparative sales values may also be used to establish fair value. When market information is not readily available, the inputs are based on the Company s understanding of market conditions and the experience of the Company s management team. Actual results could differ significantly from the Company s estimates. The discount rates used in the fair value estimates represent a rate commensurate with the indicated holding period with a premium layered on for risk. There were no impairment charges recorded during the three or nine months ended September 30, 2017 or 2016.

Property Acquisitions. Effective January 1, 2017, the Company adopted Accounting Standards Update (ASU) 2017-1, *Business Combinations* (Topic 805): *Clarifying the Definition of a Business* which requires that when substantially all of the fair value of the gross assets acquired (or disposed of) is concentrated in a single identifiable asset or a group of similar identifiable assets, the integrated set of assets and activities is not considered a business. To be a business, the set of acquired activities and assets must include inputs and one or more substantive processes that together contribute to the ability to create outputs. The Company has determined that its real estate property acquisitions will generally be accounted for as asset acquisitions under the clarified definition. Prior to January 1, 2017 the Company generally accounted for property acquisitions as business combinations, in accordance with Accounting Standards Codification (ASC) 805, *Business Combinations*. Upon acquisition of a property the Company estimates the fair value of acquired tangible assets (consisting generally of land, buildings and improvements) and intangible assets and liabilities (consisting generally of the above and below-market leases and the origination value of all in-place leases). The Company determines fair values using Level 3 inputs such as replacement cost, estimated cash flow projections and other valuation techniques and applying appropriate discount and capitalization rates based on available market information. Mortgage loans assumed in connection with acquisitions are recorded at their fair value using current market interest rates for similar debt at the date of acquisition. Acquisition-related costs associated with asset acquisitions are capitalized to individual tangible and intangible assets and liabilities assumed on a relative fair value basis and acquisition-related costs associated with business combinations are expensed as incurred.

The fair value of the tangible assets is determined by valuing the property as if it were vacant. Land values are derived from current comparative sales values, when available, or management s estimates of the fair value based on market conditions and the experience of the Company s management team. Building and improvement values are calculated as replacement cost less depreciation, or management s estimates of the fair value of these assets using discounted cash flow analyses or similar methods. The fair value of the above and below-market leases is based on the present value of the difference between the contractual amounts to be received pursuant to the acquired leases (using a discount rate that reflects the risks associated with the acquired leases) and the Company s estimate of the market lease rates measured over a period equal to the remaining term of the leases plus the term of any below-market fixed rate renewal options. The above and below-market lease values are amortized to rental revenues over the remaining initial term plus the term of any below-market fixed rate renewal options that are considered bargain renewal options of the respective leases. The total net impact to rental revenues due to the amortization of above and below-market leases was a net increase of approximately $0.7 million and $0.3 million, respectively, for the three months ended

September 30, 2017 and 2016, and approximately $1.5 million and $1.0 million, respectively, for the nine months ended September 30, 2017 and 2016. The origination value of in-place leases is based on costs to execute similar leases, including commissions and other related costs. The origination value of in-place leases also includes real estate taxes, insurance and an estimate of lost rental revenue at market rates during the estimated time required to lease up the property from vacant to the occupancy level at the date of acquisition. The remaining weighted average lease term related to these intangible assets and liabilities as of September 30, 2017 is 9.4 years. As of September 30, 2017 and December 31, 2016, the Company s intangible assets and liabilities, including properties held for sale (if any), consisted of the following (dollars in thousands):

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	September 30, 2017			December 31, 2016		
	Gross	Accumulated Amortization	Net	Gross	Accumulated Amortization	Net
In-place leases	$ 65,880	$ (43,741)	$ 22,139	$ 58,112	$ (37,664)	$ 20,448
Above-market leases	$ 4,527	$ (3,612)	$ 915	$ 4,468	$ (3,319)	$ 1,149
Below-market leases	$ (27,591)	$ 7,302	$ (20,289)	$ (9,133)	$ 5,648	$ (3,485)

Depreciation and Useful Lives of Real Estate and Intangible Assets. Depreciation and amortization are computed on a straight-line basis over the estimated useful lives of the related assets or liabilities. The following table reflects the standard depreciable lives typically used to compute depreciation and amortization. However, such depreciable lives may be different based on the estimated useful life of such assets or liabilities.

Description	Standard Depreciable Life
Land	Not depreciated
Building	40 years
Building Improvements	5-40 years
Tenant Improvements	Shorter of lease term or useful life
Leasing Costs	Lease term
In-place leases	Lease term
Above/Below-Market Leases	Lease term

Discontinued Operations. The Company considers a property to be classified as discontinued operations when it meets the criteria established under ASU 2014-08, *Presentation of Financial Statements* (Topic 205) and *Property, Plant and Equipment* (Topic 360), *Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity*. Disposals that represent a strategic shift that should have or will have a major effect on the Company s operations and financial results qualify as discontinued operations.

Held for Sale Assets. The Company considers a property to be held for sale when it meets the criteria established under ASC 360, *Property, Plant and Equipment* (Note 5). Properties held for sale are reported at the lower of the carrying amount or fair value less estimated costs to sell and are not depreciated while they are held for sale.

Cash and Cash Equivalents. Cash and cash equivalents consists of cash held in a major banking institution and other highly liquid short-term investments with original maturities of three months or less. Cash equivalents are generally invested in U.S. government securities, government agency securities or money market accounts.

Restricted Cash. Restricted cash includes cash held in escrow in connection with property acquisitions and reserves for certain capital improvements, leasing, interest and real estate tax and insurance payments as required by certain mortgage loan obligations.

The following summarizes the reconciliation of cash and cash equivalents and restricted cash as presented in the accompanying consolidated statements of cash flows:

	For the Nine Months Ended September 30,	
	2017	2016
Beginning		
	$ 14,208	$ 22,450

Cash and cash equivalents at beginning of period				
Restricted cash		4,270		2,658
Cash and cash equivalents and restricted cash		18,478		25,108
Ending				
Cash and cash equivalents at end of period		109,058		10,919
Restricted cash		4,265		3,550
Cash and cash equivalents and restricted cash		113,323		14,469
Net increase (decrease) in cash and cash equivalents and restricted cash	$	94,845	$	(10,639)

Revenue Recognition. The Company records rental revenue from operating leases on a straight-line basis over the term of the leases and maintains an allowance for estimated losses that may result from the inability of its tenants to make required payments. If tenants fail to make contractual lease payments that are greater than the Company s allowance for doubtful accounts, security deposits and letters of credit, then the Company may have to recognize additional doubtful account charges in future periods. The Company monitors the liquidity and creditworthiness of its tenants on an on-going basis by reviewing their financial condition periodically as appropriate. Each period the Company reviews its outstanding accounts receivable, including straight-line rents, for doubtful accounts and provides allowances as needed. The Company also records lease termination fees when a tenant has executed a definitive termination agreement with the Company and the payment of the termination fee is not subject to any conditions that must be met or waived before the fee is due to the Company. If a tenant remains in the leased space following the execution of a definitive termination agreement, the applicable termination will be deferred and recognized over the term of such tenant s occupancy.

Tenant expense reimbursement income includes payments and amounts due from tenants pursuant to their leases for real estate taxes, insurance and other recoverable property operating expenses and is recognized as revenues during the same period the related expenses are incurred.

As of September 30, 2017 and December 31, 2016, approximately $21.2 million and $21.6 million, respectively, of straight-line rent and accounts receivable, net of allowances of approximately $0.2 million and $0.4 million as of September 30, 2017 and December 31, 2016, respectively, were included as a component of other assets in the accompanying consolidated balance sheets.

Deferred Financing Costs. Costs incurred in connection with financings are capitalized and amortized to interest expense using the effective interest method over the term of the related loan. Deferred financing costs associated with the revolving credit facility are classified as an asset and deferred financing costs associated with debt liabilities are reported as a direct deduction from the carrying amount of the debt liability in the accompanying consolidated balance sheets. Deferred financing costs related to the revolving credit facility and debt liabilities are shown at cost, net of accumulated amortization in the aggregate of approximately $5.4 million and $4.5 million as of September 30, 2017 and December 31, 2016, respectively.

Mortgage Premiums. Mortgage premiums represent the excess of the fair value of debt assumed over the principal value of debt assumed in connection with property acquisitions. The mortgage premiums are being amortized to interest expense over the term of the related debt instrument using the effective interest method. As of September 30, 2017 and December 31, 2016, the mortgage premiums were fully amortized.

Income Taxes. The Company elected to be taxed as a REIT under the Code and operates as such beginning with its taxable year ended December 31, 2010. To qualify as a REIT, the Company must meet certain organizational and operational requirements, including a requirement to distribute at least 90% of its annual REIT taxable income to its stockholders (which is computed without regard to the dividends paid deduction or net capital gain and which does not necessarily equal net income as calculated in accordance with GAAP). As a REIT, the Company generally will not be subject to federal income tax to the extent it distributes qualifying dividends to its stockholders. If it fails to qualify as a REIT in any taxable year, it will be subject to federal income tax on its taxable income at regular corporate income tax rates and generally will not be permitted to qualify for treatment as a REIT for federal income tax purposes for the four taxable years following the year during which qualification is lost unless the IRS grants it relief under certain statutory provisions. Such an event could materially adversely affect the Company s net income and net cash available for distribution to stockholders. However, the Company believes it is organized and operates in such a manner as to qualify for treatment as a REIT.

ASC 740-10, *Income Taxes,* provides guidance for how uncertain tax positions should be recognized, measured, presented and disclosed in the financial statements. ASC 740-10 requires the evaluation of tax positions taken in the course of preparing the Company s tax returns to determine whether the tax positions are more-likely-than-not of being sustained by the applicable tax authority. Tax benefits of positions not deemed to meet the more-likely-than-not threshold are recorded as a tax expense in the current year. As of September 30, 2017 and December 31, 2016, the Company did not have any unrecognized tax benefits and does not believe that there will be any material changes in unrecognized tax positions over the next 12 months. The Company s tax returns are subject to examination by federal, state and local tax jurisdictions beginning with the 2010 calendar year.

Stock-Based Compensation and Other Long-Term Incentive Compensation. The Company follows the provisions of ASC 718, *Compensation-Stock Compensation,* to account for its stock-based compensation plan, which requires that the compensation cost relating to stock-based payment transactions be recognized in the financial statements and that the cost be

measured on the fair value of the equity or liability instruments issued. The Company has adopted the Amended and Restated 2010 Equity Incentive Plan, which provides for the grant of restricted stock awards, performance share awards, unrestricted shares or any combination of the foregoing. Stock-based compensation is recognized as a general and administrative expense in the accompanying consolidated statements of operations and measured at the fair value of the award on the date of grant. The Company estimates the forfeiture rate based on historical experience as well as expected behavior. The amount of the expense may be subject to adjustment in future periods depending on the specific characteristics of the stock-based award.

In addition, the Company has awarded long-term incentive target awards (the Performance Share awards) to its executives that may be payable in shares of the Company s common stock after the conclusion of each pre-established performance measurement period, which is generally three years. The amount that may be earned under the Performance Share awards is variable depending on the relative total shareholder return of the Company s common stock as compared to the total shareholder return of the MSCI U.S. REIT Index (RMS) and the FTSE NAREIT Equity Industrial Index over the pre-established performance measurement period. The Company estimates the fair value of the Performance Share awards using a Monte Carlo simulation model on the date of grant and at each reporting period. The Performance Share awards are recognized as compensation expense over the requisite performance period based on the fair value of the Performance Share awards at the balance sheet date and vary quarter to quarter based on the Company s relative share price performance.

Use of Derivative Financial Instruments. ASC 815, *Derivatives and Hedging* (Note 7), provides the disclosure requirements for derivatives and hedging activities with the intent to provide users of financial statements with an enhanced understanding of: (a) how and why the Company uses derivative instruments, (b) how the Company accounts for derivative instruments and related hedged items, and (c) how derivative instruments and related hedged items affect the Company s financial position, financial performance, and cash flows. Further, qualitative disclosures are required that explain the Company s objectives and strategies for using derivatives, as well as quantitative disclosures about the fair value of and gains and losses on derivative instruments.

The Company records all derivatives on the accompanying consolidated balance sheets at fair value. The accounting for changes in the fair value of derivatives depends on the intended use of the derivative, whether the Company has elected to designate a derivative in a hedging relationship and apply hedge accounting and whether the hedging relationship has satisfied the criteria necessary to apply hedge accounting. Derivatives designated and qualifying as a hedge of the exposure to changes in the fair value of an asset, liability, or firm commitment attributable to a particular risk, such as interest rate risk, are considered fair value hedges. Derivatives designated and qualifying as a hedge of the exposure to variability in expected future cash flows, or other types of forecasted transactions, are considered cash flow hedges. Hedge accounting generally provides for the matching of the timing of gain or loss recognition on the hedging instrument with the recognition of the changes in the fair value of the hedged asset or liability that are attributable to the hedged risk in a fair value hedge or the earnings effect of the hedged forecasted transactions in a cash flow hedge. The Company may enter into derivative contracts that are intended to economically hedge certain of its risks, even though hedge accounting does not apply or the Company elects not to apply hedge accounting.

As of September 30, 2017, the Company had three interest rate caps to hedge the variable cash flows associated with its existing $150.0 million of variable-rate term loans. The caps have a notional value of $150.0 million and will effectively cap the annual interest rate at 4.0% plus 1.30% to 1.85%, depending on leverage, with respect to $50.0 million for the period from December 1, 2014 (effective date) to May 1, 2021, $50.0 million for the period from September 1, 2015 (effective date) to April 1, 2019, and $50.0 million for the period from September 1, 2015 (effective date) to February 3, 2020. The Company records all derivative instruments on a gross basis in other assets on the accompanying consolidated balance sheets, and accordingly, there are no offsetting amounts that net assets against liabilities. As of September 30, 2017 and December 31, 2016, the fair value of the interest rate caps was

approximately $37,000 and $0.3 million, respectively.

***Fair Value of Financial Instruments*.** ASC 820, *Fair Value Measurements and Disclosures* (Note 8), defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. ASC 820 also provides guidance for using fair value to measure financial assets and liabilities. ASC 820 requires disclosure of the level within the fair value hierarchy in which the fair value measurements fall, including measurements using quoted prices in active markets for identical assets or liabilities (Level 1), quoted prices for similar instruments in active markets or quoted prices for identical or similar instruments in markets that are not active (Level 2), and significant valuation assumptions that are not readily observable in the market (Level 3).

New Accounting Standards. In May 2014, the Financial Accounting Standards Board (FASB) issued ASU 2014-09, which created ASC Topic 606, *Revenue from Contracts with Customers,* which is their final standard on revenue from contracts with customers. ASU 2014-09 outlines a single comprehensive model for entities to use in accounting for revenues arising from contracts with customers. The effective date of ASU 2014-09 was deferred by the issuance of ASU 2015-14,

Revenue from Contracts with Customers (Topic 606): *Deferral of the Effective Date,* by one year to make the guidance of ASU 2014-09 effective for annual reporting periods beginning after December 15, 2017, including interim periods therein. Early adoption is permitted but not prior to the original effective date, which was for annual reporting periods beginning after December 15, 2016. The Company will adopt the guidance effective January 1, 2018. In March 2016, the FASB issued ASU 2016-08, *Revenue from Contracts with Customers* (Topic 606): *Principal versus Agent Considerations (Reporting Revenue Gross versus Net)*, which clarifies how to apply the implementation guidance on principal versus agent considerations related to the sale of goods or services to a customer as updated by ASU 2014-09. In April 2016, the FASB issued ASU 2016-10, *Revenue from Contracts with Customers* (Topic 606): *Identifying Performance Obligations and Licensing*, which clarifies two aspects of Topic 606: (1) identifying performance obligations and (2) the licensing implementation guidance, while retaining the related principles for those areas. The effective date and transition requirements for ASU 2016-10 are the same as the effective date and transition requirements in ASU 2015-14. In May 2016, the FASB issued ASU 2016-12, *Revenue from Contracts with Customers* (Topic 606): *Narrow-Scope Improvements and Practical Expedients*, which makes narrow scope amendments to Topic 606 including implementation issues on collectability, non-cash consideration and completed contracts at transition. In December 2016, the FASB issued ASU 2016-20, *Technical Corrections and Improvements to Topic 606, Revenue from Contracts with Customers*, which make additional narrow scope amendments to Topic 606 including loan guarantee fees, impairment testing of contract costs, provisions for losses on construction-type and production-type contracts. The FASB allows two adoption methods under ASU 2014-09. Under one method, a company will apply the rules to contracts in all reporting periods presented, subject to certain allowable exceptions. Under the other method, a company will apply the rules to all contracts existing as of January 1, 2018, recognizing in beginning retained earnings an adjustment for the cumulative effect of the change and providing additional disclosures comparing results to previous rules (modified retrospective method). The Company will adopt these updates beginning with the first quarter of its fiscal year 2018 and anticipates doing so using the modified retrospective method. Currently, the Company is in the process of evaluating the impact of the adoption of ASU 2014-09. The Company s assessment efforts to date have included reviewing current accounting policies and processes, as well assigning internal resources to assist in the process. Additionally, the Company is in the process of reviewing historical contracts and other arrangements to identify potential differences that could arise from the adoption of ASU 2014-09. The Company believes the effects on its existing accounting policies will be associated with the amount and timing of historical real estate sales contracts and associated gain recognitions. As the Company progresses further in its analysis, the scope of this assessment could be expanded to include other contract elements that could have an accounting impact under the new standard. The Company is also continuing to assess the potential effects that this new standard is expected to have on its consolidated financial statements as it relates to its leasing arrangements with its tenants and in concert with its assessment and anticipated adoption of the new leasing guidance under ASU 2016-02, *Leases* (see below). The Company does not expect that this change will have a material effect on its financial position or results of operations. The Company continues to evaluate other areas of the standard and is currently assessing the impact on its consolidated financial statements and condensed notes to its consolidated financial statements and cannot reasonably estimate quantitative information related to the impact of the new standard on its consolidated financial statements at this time.

In February 2016, the FASB issued ASU 2016-02, *Leases* (Topic 842). The ASU increases transparency and comparability among organizations by recognizing lease assets and liabilities on the balance sheet and disclosing key information about leasing arrangements. The standard requires that non-lease components, such as tenant expense reimbursement revenues, be accounted for in accordance with ASU 2014-09, *Revenue from Contracts with Customers* (see above), which could change the classification and timing of its non-lease components. The ASU is effective for fiscal years beginning after December 15, 2018, including interim periods within those years, which for the Company would be the first quarter of 2019, and early adoption is permitted. The Company is currently assessing the potential changes to its accounting and whether such changes will have a material impact on its consolidated financial statements and condensed notes to its consolidated financial statements.

In August 2016, the FASB issued ASU 2016-15, *Statement of Cash Flows* (Topic 230): *Classification of Certain Cash Receipts and Cash Payments,* which provides clarified guidance on the presentation and classification of certain cash receipts and cash payments in the statement of cash flows. ASU 2016-15 is effective for fiscal years after December 15, 2017, and interim periods within those fiscal years and early adoption is permitted. The Company is currently assessing the impact of adopting ASU 2016-15 on its consolidated financial statements and condensed notes to its consolidated financial statements, but does not expect the adoption of ASU 2016-15 to have a material impact.

In November 2016, the FASB issued ASU 2016-18, *Statement of Cash Flows* (Topic 230): *Restricted Cash*, which requires that a statement of cash flows explain the change during the period in the total of cash, cash equivalents, and amounts generally described as restricted cash or restricted cash equivalents. As a result, amounts generally described as restricted cash and restricted cash equivalents should be included with cash and cash equivalents when reconciling the beginning-of-period and end-of-period total amounts shown on the statement of cash flows. The amendments do not provide a definition of

restricted cash or restricted cash equivalents. The Company elected to early adopt the provisions of ASU 2016-18 as of March 31, 2017, and has revised its consolidated statements of cash flows for the period ended September 30, 2016 to reflect amounts described as restricted cash and restricted cash equivalents included with cash and cash equivalents in the reconciliation of beginning of period and end of period total amounts shown on the consolidated statements of cash flows. Consequently, transfers between cash and restricted cash will not be presented as a separate line item in the operating, investing or financing sections of the cash flow statement. A reconciliation of cash and cash equivalents and restricted cash as presented on the consolidated balance sheets to the consolidated statements of cash flows is included in the significant accounting policies above.

Segment Disclosure. ASC 280, *Segment Reporting*, establishes standards for reporting financial and descriptive information about an enterprise s reportable segments. The Company has determined that it has one reportable segment, with activities related to investing in real estate. The Company s investments in real estate are geographically diversified and the chief operating decision makers evaluate operating performance on an individual asset level. As each of the Company s assets has similar economic characteristics, the assets have been aggregated into one reportable segment.

Note 3. Concentration of Credit Risk

Financial instruments that potentially subject the Company to a significant concentration of credit risk consist primarily of cash and cash equivalents. The Company may maintain deposits in federally insured financial institutions in excess of federally insured limits. However, the Company s management believes the Company is not exposed to significant credit risk due to the financial position of the depository institutions in which those deposits are held.

As of September 30, 2017, the Company owned 54 buildings aggregating approximately 3.1 million square feet and four land parcels consisting of approximately 23.3 acres located in Northern New Jersey/New York City, which accounted for a combined percentage of approximately 26.2% of its annualized base rent, and 25 buildings aggregating approximately 2.3 million square feet and one land parcel consisting of approximately 13.4 acres located in Washington, D.C., which accounted for a combined percentage of approximately 19.2% of its annualized base rent. Such annualized base rent percentages are based on contractual base rent from leases in effect as of September 30, 2017, excluding any partial or full rent abatements.

Other real estate companies compete with the Company in its real estate markets. This results in competition for tenants to occupy space. The existence of competing properties could have a material impact on the Company s ability to lease space and on the level of rent that can be achieved. The Company had no tenants that accounted for greater than 10% of its rental revenues for the nine months ended September 30, 2017.

Note 4. Investments in Real Estate

During the three months ended September 30, 2017, the Company acquired eight industrial buildings containing approximately 258,000 square feet and one land parcel containing approximately 1.1 acres. The total aggregate initial investment, including acquisition costs, was approximately $53.9 million, of which $32.6 million was recorded to land, $18.5 million to buildings and improvements, $2.8 million to intangible assets and $1.4 million to intangible liabilities.

During the nine months ended September 30, 2017, the company acquired 21 industrial buildings containing approximately 1,156,000 square feet and three land parcels containing approximately 18.9 acres. The total aggregate initial investment, including acquisition costs, was approximately $209.8 million, of which $144.9 million was recorded to land, $55.2 million to buildings and improvements, $9.7 million to intangible assets and $18.7 million to

intangible liabilities.

The Company recorded revenues and net income for the three months ended September 30, 2017 of approximately $2.6 million and $1.0 million, respectively, and recorded revenues and net income for the nine months ended September 30, 2017 of approximately $3.9 million and $1.6 million, respectively, related to the 2017 acquisitions.

During the three months ended September 30, 2016, the Company acquired five industrial buildings containing approximately 244,000 square feet and one improved land parcel containing approximately 13.4 acres. The total aggregate initial investment was approximately $36.7 million, of which $14.8 million was recorded to land, $17.7 million to buildings and improvements, $4.2 million to intangible assets and $0.2 million to intangible liabilities.

During the nine months ended September 30, 2016, the Company acquired 12 industrial buildings containing approximately 531,000 square feet and two improved land parcels containing approximately 17.9 acres. The total aggregate initial investment was approximately $86.0 million, of which $41.4 million was recorded to land, $37.3 million to buildings and improvements, $7.3 million to intangible assets and $1.4 million to intangible liabilities.

The Company recorded revenues and net income for the three months ended September 30, 2016 of approximately $1.4 million and $0.5 million, respectively, and recorded revenues and net income for the nine months ended September 30, 2016 of approximately $2.3 million and $0.7 million, respectively, related to the 2016 acquisitions.

The above assets and liabilities were recorded at fair value, which uses Level 3 inputs. The properties were acquired from unrelated third parties using existing cash on hand, proceeds from property sales, issuance of common stock and borrowings on the revolving credit facility. Effective January 1, 2017, the Company adopted ASU 2017-1, *Business Combinations* (Topic 805): *Clarifying the Definition of a Business* under which property acquisitions are generally accounted for as asset acquisitions resulting in the capitalization of acquisition costs as part of the purchase price of the acquisition, instead of being expensed as incurred. Prior to January 1, 2017 the Company accounted for property acquisitions as business combinations, in accordance with ASC 805, *Business Combinations,* resulting in the expense of acquisition costs as incurred.

During 2016, the Company completed redevelopment of its South Main Street property in Carson, California. The Company demolished three buildings totaling approximately 186,000 square feet, constructed a new front-load industrial distribution building containing approximately 210,000 square foot and renovated an existing approximately 34,000 square foot office building. The Company capitalized interest associated with redevelopment and expansion activities of approximately $0 and $0.2 million, respectively, during the three months ended September 30, 2017 and 2016 and $0 and $0.6 million, respectively, during the nine months ended September 30, 2017 and 2016. The redevelopment cost was approximately $17.8 million for a total investment of approximately $39.3 million, excluding approximately $2.3 million of intangible liabilities.

Pro Forma Financial Information:

The following supplementary pro forma financial information presents the results of operations of the Company for the three and nine months ended September 30, 2017 and 2016 as if all of the Company s acquisitions during the nine months ended September 30, 2017 occurred on January 1, 2016. The following pro forma results for the three and nine months ended September 30, 2017 and 2016 have been presented for comparative purposes only and are not necessarily indicative of the results of operations that would have actually occurred had all transactions taken place on January 1, 2016, or of future results of operations (dollars in thousands, except per share data).

	For the Three Months Ended September 30,		***For the Nine Months Ended September 30,***	
	2017	***2016***	***2017***	***2016***
Total revenues	$ 33,907	$ 29,190	$ 102,302	$ 86,921
Net income available to common stockholders, net of redemption of preferred stock and preferred stock dividends	18,817	2,769	39,454	13,317
Basic and diluted net income available to common stockholders per share, net of	$ 0.36	$ 0.06	$ 0.78	$ 0.30

redemption of preferred stock and preferred stock dividends

Note 5. Held for Sale/Disposed Assets

The Company considers a property to be held for sale when it meets the criteria established under ASC 360, *Property, Plant, and Equipment*. Properties held for sale are reported at the lower of the carrying amount or fair value less estimated costs to sell and are not depreciated while they are held for sale. As of September 30, 2017, the Company has entered into an agreement with a third-party purchaser to sell one property located in the Washington, D.C. market for a sales price of approximately $11.5 million (net book value of approximately $6.1 million). The sale of the property is subject to the purchaser s completion of satisfactory due diligence and various closing conditions.

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The following summarizes the condensed results of operations of the property held for sale as of September 30, 2017, for the three and nine months ended September 30, 2017 and 2016 (dollars in thousands):

	For the Three Months Ended September 30,		*For the Nine Months Ended September 30,*	
	2017	*2016*	*2017*	*2016*
Rental revenues	$ 146	$ 143	$ 434	$ 431
Tenant expense reimbursements	64	83	194	207
Property operating expenses	(64)	(84)	(197)	(217)
Depreciation and amortization	(39)	(39)	(116)	(119)
Income from operations	$ 107	$ 103	$ 315	$ 302

During the nine months ended September 30, 2017, the Company sold one property located in the Los Angeles market for a sales price of approximately $25.3 million, resulting in a gain of approximately $10.1 million, and two properties located in the Washington, D.C. market for an aggregate sales price of approximately $40.5 million, resulting in an aggregate gain of approximately $15.4 million.

During the nine months ended September 30, 2016, the Company sold one property located in the San Francisco Bay Area market for a sales price of approximately $8.2 million, resulting in a gain of approximately $2.7 million, one property in the Washington D.C./Baltimore market for a sales price of approximately $8.2 million, resulting in a gain of approximately $2.5 million, and one property located in the Miami market for a sales price of approximately $6.1 million, resulting in a gain of approximately $1.9 million.

Note 6. Debt

On July 14, 2017, the Company issued in a private placement $100.0 million of senior unsecured notes with a seven-year term that bear interest at a fixed annual interest rate of 3.75% and mature in July 2024 (the July 2024 Senior Unsecured Notes). Net proceeds from the issuance were used to redeem all 1,840,000 outstanding shares of 7.75% Series A Cumulative Redeemable Preferred Stock (the Series A Preferred Stock), to repay the outstanding borrowings on the Company s revolving credit facility, and for property acquisitions. As of September 30, 2017, the Company also had $50.0 million of senior unsecured notes that mature in September 2022, $50.0 million of senior unsecured notes that mature in July 2026, $50.0 million of senior unsecured notes that mature in October 2027 (collectively, with the July 2024 Senior Unsecured Notes, the Senior Unsecured Notes), and a credit facility (the Facility), which consists of a $200.0 million unsecured revolving credit facility that matures in August 2020, a $50.0 million term loan that matures in August 2021 and a $100.0 million term loan that matures in January 2022. As of September 30, 2017 and December 31, 2016, there was $0 and $51.5 million, respectively, of borrowings outstanding on the revolving credit facility and $150.0 million and $150.0 million, respectively, of borrowings outstanding on the term loans. As of both September 30, 2017 and December 31, 2016, the Company had three interest rate caps to hedge the variable cash flows associated with its existing $150.0 million of variable-rate term loans. See Note 7-Derivative Financial Instruments for more information regarding the Company s interest rate caps.

The aggregate amount of the Facility may be increased to a total of up to $600.0 million, subject to the approval of the administrative agent and the identification of lenders willing to make available additional amounts. Outstanding borrowings under the Facility are limited to the lesser of (i) the sum of the $150.0 million of term loans and the $200.0 million revolving credit facility, or (ii) 60.0% of the value of the unencumbered properties. Interest on the

Facility, including the term loans, is generally to be paid based upon, at the Company s option, either (i) LIBOR plus the applicable LIBOR margin or (ii) the applicable base rate which is the greatest of the administrative agent s prime rate, 0.50% above the federal funds effective rate, or thirty-day LIBOR plus the applicable LIBOR margin for LIBOR rate loans under the Facility plus 1.25%. The applicable LIBOR margin will range from 1.35% to 1.90% (1.35% as of September 30, 2017) for the revolving credit facility and 1.30% to 1.85% (1.30% as of September 30, 2017) for the $50.0 million term loan that matures in August 2021 and the $100.0 million term loan that matures in January 2022, depending on the ratio of the Company s outstanding consolidated indebtedness to the value of the Company s consolidated gross asset value. The Facility requires quarterly payments of an annual unused facility fee in an amount equal to 0.20% or 0.25% depending on the unused portion of the Facility.

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The Facility and the Senior Unsecured Notes are guaranteed by the Company and by substantially all of the current and to-be-formed subsidiaries of the borrower that own an unencumbered property. The Facility and the Senior Unsecured Notes are unsecured by the Company s properties or by interests in the subsidiaries that hold such properties. The Facility and the Senior Unsecured Notes include a series of financial and other covenants with which the Company must comply. The Company was in compliance with the covenants under the Facility and the Senior Unsecured Notes as of September 30, 2017 and December 31, 2016.

The Company has mortgage loans payable which are collateralized by certain of the properties and require monthly interest and principal payments until maturity and are generally non-recourse. The mortgage loans mature between 2019 and 2021. As of September 30, 2017, the Company had three mortgage loans payable, net of deferred financings costs, totaling approximately $65.3 million, which bear interest at a weighted average fixed annual rate of 4.0%. As of December 31, 2016, the Company had four mortgage loans payable, net of deferred financing costs, totaling approximately $66.6 million, which bore interest at a weighted average fixed annual interest rate of 4.0%. As of September 30, 2017 and December 31, 2016, the total gross book value of the properties securing the debt was approximately $153.3 million and $163.1 million, respectively.

The scheduled principal payments of the Company s debt as of September 30, 2017 were as follows (dollars in thousands):

	Credit Facility	Term Loans	Senior Unsecured Notes	Mortgage Loans Payable	Total Debt
2017 (3 months)	$	$	$	$ 466	$ 466
2018				1,910	1,910
2019				18,805	18,805
2020				33,077	33,077
2021		50,000		11,271	61,271
Thereafter		100,000	250,000		350,000
Subtotal		150,000	250,000	65,529	465,529
Unamortized net premiums					