

Public Storage  
Form 10-Q  
August 05, 2016

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 June 30, 2016

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: 001-33519

PUBLIC STORAGE

(Exact name of registrant as specified in its charter)

Maryland (State or other jurisdiction of incorporation or organization)	95-3551121 (I.R.S. Employer Identification Number)
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701 Western Avenue, Glendale, California (Address of principal executive offices)	91201-2349 (Zip Code)
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Registrant's telephone number, including area code: (818) 244-8080.

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 at least 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).

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Yes  No

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

Large Accelerated Filer   Accelerated Filer   Non-accelerated Filer   Smaller Reporting Company

                                                                                                          

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes  No

Indicate the number of the registrant’s outstanding common shares of beneficial interest, as of August 3, 2016:

Common Shares of beneficial interest, \$.10 par value per share – 173,401,388 shares

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PUBLIC STORAGE

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## PUBLIC STORAGE

## BALANCE SHEETS

(Amounts in thousands, except share data)

(Unaudited)

	June 30, 2016	December 31, 2015
<b>ASSETS</b>		
Cash and cash equivalents	\$ 260,124	\$ 104,285
Real estate facilities, at cost:		
Land	3,686,289	3,564,810
Buildings	9,884,371	9,640,451
	13,570,660	13,205,261
Accumulated depreciation	(5,064,423)	(4,866,738)
	8,506,237	8,338,523
Construction in process	228,103	219,190
	8,734,340	8,557,713
Investments in unconsolidated real estate entities	696,069	809,308
Goodwill and other intangible assets, net	213,396	211,458
Other assets	93,208	95,468
Total assets	\$ 9,997,137	\$ 9,778,232
<b>LIABILITIES AND EQUITY</b>		
Senior unsecured notes	\$ 379,792	\$ 263,940
Mortgage notes	57,043	55,076
Preferred shares called for redemption (Note 7)	487,500	-
Accrued and other liabilities	305,769	261,578
Total liabilities	1,230,104	580,594
Commitments and contingencies (Note 11)		
Equity:		
Public Storage shareholders' equity:		

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Preferred Shares, \$0.01 par value, 100,000,000 shares authorized, 147,700 shares issued (in series) and outstanding, (162,200 at December 31, 2015), at liquidation preference	3,692,500	4,055,000
Common Shares, \$0.10 par value, 650,000,000 shares authorized, 173,098,015 shares issued and outstanding (172,921,241 shares at December 31, 2015)	17,310	17,293
Paid-in capital	5,598,846	5,601,506
Accumulated deficit	(491,912)	(434,610)
Accumulated other comprehensive loss	(78,991)	(68,548)
Total Public Storage shareholders' equity	8,737,753	9,170,641
Noncontrolling interests	29,280	26,997
Total equity	8,767,033	9,197,638
Total liabilities and equity	\$ 9,997,137	\$ 9,778,232

See accompanying notes.

## PUBLIC STORAGE

## STATEMENTS OF INCOME

(Amounts in thousands, except per share amounts)

(Unaudited)

	Three Months Ended		Six Months Ended	
	June 30,	2015	June 30,	2015
	2016		2016	
Revenues:				
Self-storage facilities	\$ 594,387	\$ 551,028	\$ 1,168,973	\$ 1,081,665
Ancillary operations	39,801	37,587	77,001	71,829
	634,188	588,615	1,245,974	1,153,494
Expenses:				
Self-storage cost of operations	157,687	147,826	317,550	309,068
Ancillary cost of operations	14,317	13,271	27,740	24,041
Depreciation and amortization	107,013	106,473	212,141	213,619
General and administrative	18,321	20,988	41,368	45,148
	297,338	288,558	598,799	591,876
Operating income	336,850	300,057	647,175	561,618
Interest and other income	4,028	3,815	7,864	7,852
Interest expense	(1,378)	-	(2,089)	-
Equity in earnings of unconsolidated real estate entities	10,227	7,480	24,391	23,664
Foreign currency exchange gain (loss)	8,632	-	(2,322)	-
Gain on real estate investment sales	-	16,688	689	18,160
Net income	358,359	328,040	675,708	611,294
Allocation to noncontrolling interests	(1,700)	(1,635)	(3,176)	(3,108)
Net income allocable to Public Storage shareholders	356,659	326,405	672,532	608,186
Allocation of net income to:				
Preferred shareholders	(59,216)	(61,449)	(121,488)	(125,004)
Preferred shareholders - redemptions (Note 7)	(15,537)	-	(26,873)	(4,784)
Restricted share units	(1,131)	(1,030)	(2,061)	(1,859)
Net income allocable to common shareholders	\$ 280,775	\$ 263,926	\$ 522,110	\$ 476,539
Net income per common share:				
Basic	\$ 1.62	\$ 1.53	\$ 3.02	\$ 2.76

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Diluted	\$ 1.61	\$ 1.52	\$ 3.00	\$ 2.75
Basic weighted average common shares outstanding	173,087	172,629	173,032	172,575
Diluted weighted average common shares outstanding	174,000	173,387	173,925	173,377

See accompanying notes.

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## PUBLIC STORAGE

## STATEMENTS OF COMPREHENSIVE INCOME

(Amounts in thousands)

(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Net income	\$ 358,359	\$ 328,040	\$ 675,708	\$ 611,294
Other comprehensive income (loss):				
Aggregate foreign currency exchange income (loss)	(4,681)	17,049	(11,824)	(13,367)
Adjust for foreign currency exchange (income) loss included in net income	(6,537)	-	1,381	-
Other comprehensive income (loss)	(11,218)	17,049	(10,443)	(13,367)
Total comprehensive income	347,141	345,089	665,265	597,927
Allocation to noncontrolling interests	(1,700)	(1,635)	(3,176)	(3,108)
Comprehensive income allocable to Public Storage shareholders	\$ 345,441	\$ 343,454	\$ 662,089	\$ 594,819

See accompanying notes.

## PUBLIC STORAGE

## STATEMENTS OF EQUITY

(Amounts in thousands, except share and per share amounts)

(Unaudited)

	Cumulative Preferred Shares	Common Shares	Paid-in Capital	Accumulated Deficit	Accumulated Other Comprehensive Loss	Total Public Storage Shareholders' Equity	Noncontrolling Interests	Total Equity	
Balances at December 31, 2015		\$ 4,055,000	\$ 17,293	\$ 5,601,506	\$ (434,610)	\$ (68,548)	\$ 9,170,641	\$ 26,997	\$ 9,197,638
Cumulative effect of a change in accounting principle (Note 9)	-	-	789	(789)	-	-	-	-	-
Balances at December 31, 2015, as adjusted		4,055,000	17,293	5,602,295	(435,399)	(68,548)	9,170,641	26,997	9,197,638
Issuance of 20,000 preferred shares (Note 7)	500,000	-	(16,322)	-	-	483,678	-	-	483,678
Redemption of 34,500 preferred shares (Note 7)	(862,500)	-	-	-	-	(862,500)	-	-	(862,500)
Issuance of common shares in connection with share-based compensation (176,774 shares)									

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(Note 9)	-	17	10,708	-	-	10,725	-	10,725
Cash paid in lieu of common shares, net of share-based compensation expense (Note 9)	-	-	2,165	-	-	2,165	-	2,165
Contributions by noncontrolling interests	-	-	-	-	-	-	2,747	2,747
Net income	-	-	-	675,708	-	675,708	-	675,708
Net income allocated to noncontrolling interests	-	-	-	(3,176)	-	(3,176)	3,176	-
Distributions to equity holders: Preferred shares (Note 7)	-	-	-	(121,488)	-	(121,488)	-	(121,488)
Noncontrolling interests	-	-	-	-	-	-	(3,640)	(3,640)
Common shares and restricted share units (\$3.50 per share)	-	-	-	(607,557)	-	(607,557)	-	(607,557)
Other comprehensive loss (Note 2)	-	-	-	-	(10,443)	(10,443)	-	(10,443)
Balances at June 30, 2016	\$ 3,692,500	\$ 17,310	\$ 5,598,846	\$ (491,912)	\$ (78,991)	\$ 8,737,753	\$ 29,280	\$ 8,767,033

See accompanying notes.

## PUBLIC STORAGE

## STATEMENTS OF CASH FLOWS

(Amounts in thousands)

(Unaudited)

	Six Months Ended June 30, 2016	2015
Cash flows from operating activities:		
Net income	\$ 675,708	\$ 611,294
Adjustments to reconcile net income to net cash provided by operating activities:		
Gain on real estate investment sales	(689)	(18,160)
Depreciation and amortization	212,141	213,619
Equity in earnings of unconsolidated real estate entities	(24,391)	(23,664)
Distributions from retained earnings of unconsolidated real estate entities	60,587	16,361
Foreign currency exchange loss	2,322	-
Other	39,036	40,175
Total adjustments	289,006	228,331
Net cash provided by operating activities	964,714	839,625
Cash flows from investing activities:		
Capital expenditures to maintain real estate facilities	(38,236)	(29,757)
Construction in process	(134,998)	(100,393)
Acquisition of real estate facilities and intangible assets	(184,657)	(87,783)

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Distributions in excess of retained earnings from unconsolidated real estate entities	67,420	-
Proceeds from sale of real estate investments	1,393	13,929
Other	1,283	16,030
Net cash used in investing activities	(287,795)	(187,974)
Cash flows from financing activities:		
Borrowings on bank credit facility	-	11,000
Repayments on notes payable	(10,592)	(16,282)
Issuance of senior unsecured notes	113,620	-
Issuance of preferred shares	483,678	-
Issuance of common shares	10,725	10,488
Redemption of preferred shares	(375,000)	(145,000)
Cash paid upon vesting in lieu of issuing common shares	(13,304)	(13,591)
Contributions by noncontrolling interests	2,747	-
Distributions paid to Public Storage shareholders	(729,045)	(661,633)
Distributions paid to noncontrolling interests	(3,640)	(3,191)
Net cash used in financing activities	(520,811)	(818,209)
Net increase (decrease) in cash and cash equivalents	156,108	(166,558)
Net effect of foreign exchange translation on cash and cash equivalents	(269)	(898)
Cash and cash equivalents at the beginning of the period	104,285	187,712
Cash and cash equivalents at the end of the period	\$ 260,124	\$ 20,256

See accompanying notes.

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## PUBLIC STORAGE

## STATEMENTS OF CASH FLOWS

(Amounts in thousands)

(Unaudited)

	Six Months Ended June	
	30,	
	2016	2015
Supplemental schedule of non-cash investing and financing activities:		
Foreign currency translation adjustment:		
Real estate facilities, net of accumulated depreciation	\$ 641	\$ (119)
Investments in unconsolidated real estate entities	8,682	12,588
Senior unsecured notes	2,232	-
Accumulated other comprehensive loss	(11,824)	(13,367)
Preferred shares called for redemption and reclassified to liabilities	487,500	-
Preferred shares called for redemption and reclassified from equity	(487,500)	-
Real estate acquired in exchange for assumption of notes payable	(12,945)	-
Notes payable assumed in connection with acquisition of real estate	12,945	-
Accrued construction costs and capital expenditures:		
Capital expenditures to maintain real estate facilities	(6,709)	(2,704)
Construction in process	(10,904)	308
Accrued and other liabilities	17,613	2,396

See accompanying notes.

PUBLIC STORAGE

NOTES TO FINANCIAL STATEMENTS

June 30, 2016

(Unaudited)

1. Description of the Business

Public Storage (referred to herein as “the Company”, “we”, “us”, or “our”), a Maryland real estate investment trust (“REIT”), was organized in 1980. Our principal business activities include the ownership and operation of self-storage facilities which offer storage spaces for lease, generally on a month-to-month basis, for personal and business use, ancillary activities such as merchandise sales and tenant reinsurance to the tenants at our self-storage facilities, as well as the acquisition and development of additional self-storage space.

At June 30, 2016, we have direct and indirect equity interests in 2,310 self-storage facilities (with approximately 151 million net rentable square feet) located in 38 states in the United States (“U.S.”) operating under the “Public Storage” name. We also own one self-storage facility in London, England and we have a 49% interest in Shurgard Europe, which owns 217 self-storage facilities (with approximately 12 million net rentable square feet) located in seven Western European countries, all operating under the “Shurgard” name. We also have direct and indirect equity interests in approximately 29 million net rentable square feet of commercial space located in nine states in the U.S. primarily owned and operated by PS Business Parks, Inc. (“PSB”) under the “PS Business Parks” name. At June 30, 2016, we have an approximate 42% common equity interest in PSB.

Disclosures of the number and square footage of facilities, as well as the number and coverage of tenant reinsurance policies (Note 11) are unaudited and outside the scope of our independent registered public accounting firm’s review of our financial statements in accordance with the standards of the Public Company Accounting Oversight Board (U.S.).

2. Summary of Significant Accounting Policies

Basis of Presentation

The accompanying unaudited interim financial statements were prepared in accordance with U.S. generally accepted accounting principles (“GAAP”) as defined in the Financial Accounting Standards Board (“FASB”) Accounting Standards Codification (the “Codification”), including guidance with respect to interim financial information and in conformity with the instructions to Form 10-Q and Article 10 of Regulation S-X. While they do not include all of the disclosures required by GAAP for complete financial statements, we believe that we have included all adjustments (consisting of normal and recurring adjustments) necessary for a fair presentation. Operating results for the three and six months ended June 30, 2016 are not necessarily indicative of the results that may be expected for the year ending December 31, 2016 due to seasonality and other factors. These interim financial statements should be read together with the audited financial statements and related notes included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2015.

Certain amounts previously reported in our June 30, 2015 financial statements have been reclassified to conform to the June 30, 2016 presentation. We reclassified the revenues and cost of operations, net for our wholly-owned commercial facilities and property management operations as interest and other income (aggregates of approximately \$4.0 million and \$1.1 million for the three months ended June 30, 2015, respectively, and \$8.5 million and \$2.3 million for the six months ended June 30, 2015, respectively), rather than as ancillary revenues and ancillary cost of



operations. We also revised our reportable segment presentation in Note 10, including renaming (i) our “Domestic Self-Storage” segment to “Self-Storage Operations,” (ii) our “European Self-Storage” segment to “Investment in Shurgard Europe,” (iii) our “Commercial” segment to “Investment in PSB,” removing our commercial facilities’ operations from this segment, and (iv) presenting a new segment called “Ancillary Operations” reflecting the sale of merchandise at our self-storage facilities and reinsurance of policies covering losses to goods stored by our tenants at our facilities. Each of these

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PUBLIC STORAGE

NOTES TO FINANCIAL STATEMENTS

June 30, 2016

(Unaudited)

reclassifications reflects changes to enhance the usefulness of this information based upon the relative significance of these activities to our aggregate operating results.

On our statement of cash flows for the six months ended June 30, 2015, we reclassified as cash flows from financing activities the \$13.6 million we paid for the restricted share units that we withheld upon their vesting for tax requirements, in connection with a recently issued accounting pronouncement related to employee share-based payment accounting we early adopted effective January 1, 2016. We previously included these amounts within operating activities (see “Recent Accounting Pronouncements and Guidance” below).

Consolidation and Equity Method of Accounting

We consider entities to be Variable Interest Entities (“VIEs”) when they have insufficient equity to finance their activities without additional subordinated financial support provided by other parties, or the equity holders as a group do not have a controlling financial interest. We consolidate VIEs when we have (i) the power to direct the activities most significantly impacting economic performance, and (ii) either the obligation to absorb losses or the right to receive benefits from the VIE. We have no involvement with any material VIEs. We consolidate all other entities when we control them through voting shares or contractual rights. The entities we consolidate, for the period in which the reference applies, are referred to collectively as the “Subsidiaries”, and we eliminate intercompany transactions and balances.

We account for our investments in entities that we do not consolidate but have significant influence over using the equity method of accounting. These entities, for the periods in which the reference applies, are referred to collectively as the “Unconsolidated Real Estate Entities”, eliminating intra-entity profits and losses and amortizing any differences between the cost of our investment and the underlying equity in net assets against equity in earnings as if the Unconsolidated Real Estate Entity were a consolidated subsidiary.

When we begin consolidating an entity, we record a gain representing the differential between the book value and fair value of any preexisting equity interest. All changes in consolidation status are reflected prospectively.

Collectively, at June 30, 2016, the Company and the Subsidiaries own 2,298 self-storage facilities in the U.S., one self-storage facility in London, England and three commercial facilities in the U.S. At June 30, 2016, the Unconsolidated Real Estate Entities are comprised of PSB, Shurgard Europe, as well as limited partnerships that own an aggregate of 12 self-storage facilities in the U.S. (these limited partnerships, for the periods in which the reference applies, are referred to as the “Other Investments”).

Use of Estimates

The financial statements and accompanying notes reflect our estimates and assumptions. Actual results could differ from those estimates and assumptions.

Income Taxes

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We have elected to be treated as a REIT, as defined in the Internal Revenue Code of 1986, as amended (the “Code”). As a REIT, we do not incur federal income tax if we distribute 100% of our REIT taxable income each year, and if we meet certain organizational and operational rules. We believe we have met these REIT requirements for all periods presented herein. Accordingly, we have recorded no federal income tax expense related to our REIT taxable income.

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PUBLIC STORAGE

NOTES TO FINANCIAL STATEMENTS

June 30, 2016

(Unaudited)

Our merchandise and tenant reinsurance operations are subject to corporate income tax and such taxes are included in ancillary cost of operations. We also incur income and other taxes in certain states, which are included in general and administrative expense.

We recognize tax benefits of uncertain income tax positions that are subject to audit only if we believe it is more likely than not that the position would ultimately be sustained assuming the relevant taxing authorities had full knowledge of the relevant facts and circumstances of our positions. As of June 30, 2016, we had no tax benefits that were not recognized.

Real Estate Facilities

Real estate facilities are recorded at cost. We capitalize all costs incurred to develop, construct, renovate and improve facilities, including interest and property taxes incurred during the construction period. We expense internal and external transaction costs associated with acquisitions or dispositions of real estate, as well as repairs and maintenance costs, as incurred. We depreciate buildings and improvements on a straight-line basis over estimated useful lives ranging generally between 5 to 25 years.

We allocate the net acquisition cost of acquired operating self-storage facilities to the underlying land, buildings, identified intangible assets, and any noncontrolling interests that remain outstanding based upon their respective individual estimated fair values. Any difference between the net acquisition cost and the estimated fair value of the net tangible and intangible assets acquired is recorded as goodwill.

Other Assets

Other assets primarily consist of rents receivable from our tenants, prepaid expenses and restricted cash.

Accrued and Other Liabilities

Accrued and other liabilities consist primarily of rents prepaid by our tenants, trade payables, property tax accruals, accrued payroll, accrued tenant reinsurance losses, and contingent loss accruals when probable and estimable, and we believe that the fair value of our accrued and other liabilities approximates book value, due to the short period until repayment. We disclose the nature of significant unaccrued losses that are reasonably possible of occurring and, if estimable, a range of exposure.

Cash Equivalents, Marketable Securities and Other Financial Instruments

Cash equivalents represent highly liquid financial instruments such as money market funds with daily liquidity or short-term commercial paper or treasury securities maturing within three months of acquisition. Cash and cash equivalents which are restricted from general corporate use are included in other assets. Commercial paper not maturing within three months of acquisition, which we intend and have the capacity to hold until maturity, are included in marketable securities and accounted for using the effective interest method. We believe that the book

value of all such financial instruments for all periods presented approximates fair value, due to the short period to maturity.

Transfers of financial assets are recorded as sales when the asset is put presumptively beyond our and our creditors' reach, there is no impediment to the transferee's right to pledge or exchange the asset, we have surrendered effective control of the asset, we have no actual or effective right or requirement to repurchase the asset and, in the case of a transfer of a participating interest, there is no impediment to our right to pledge or exchange the participating interest we retain.

PUBLIC STORAGE

NOTES TO FINANCIAL STATEMENTS

June 30, 2016

(Unaudited)

Fair Value

As used herein, the term “fair value” is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. Our estimates of fair value involve considerable judgment and are not necessarily indicative of the amounts that could be realized in current market exchanges.

We estimate the fair value of our cash and cash equivalents, marketable securities, other assets, debt, and other liabilities by applying a discount rate to the future cash flows of the financial instrument. The discount rate is based upon quoted interest rates for securities that have similar characteristics such as credit quality and time to maturity; such quoted interest rates are referred to generally as “Level 2” inputs.

Currency and Credit Risk

Financial instruments that are exposed to credit risk consist primarily of cash and cash equivalents, certain portions of other assets including rents receivable from our tenants and restricted cash. Cash equivalents we invest in are either money market funds with a rating of at least AAA by Standard and Poor’s, commercial paper that is rated A1 by Standard and Poor’s or deposits with highly rated commercial banks.

At June 30, 2016, due primarily to our investment in Shurgard Europe (Note 4) and our senior unsecured notes denominated in Euros (Note 5), our operating results and financial position are affected by fluctuations in currency exchange rates between the Euro, and to a lesser extent, other European currencies, against the U.S. Dollar.

Goodwill and Other Intangible Assets

Intangible assets are comprised of goodwill, the “Shurgard” trade name, acquired customers in place, and leasehold interests in land.

Goodwill totaled \$174.6 million at June 30, 2016 and December 31, 2015. The “Shurgard” trade name, which is used by Shurgard Europe pursuant to a fee-based licensing agreement, has a book value of \$18.8 million at June 30, 2016 and December 31, 2015. Goodwill and the “Shurgard” trade name have indefinite lives and are not amortized.

Acquired customers in place and leasehold interests in land are finite-lived and are amortized relative to the benefit of the customers in place or the benefit to land lease expense to each period. At June 30, 2016, these intangibles had a net book value of \$19.9 million (\$18.0 million at December 31, 2015). Accumulated amortization totaled \$51.9 million at June 30, 2016 (\$66.4 million at December 31, 2015), and amortization expense of \$10.5 million and \$15.9 million was recorded in the six months ended June 30, 2016 and 2015, respectively. The estimated future amortization expense for our finite-lived intangible assets at June 30, 2016 is approximately \$7.5 million in the remainder of 2016, \$5.6 million in 2017 and \$6.8 million thereafter. During the six months ended June 30, 2016, intangibles were increased \$12.5 million in connection with the acquisition of self-storage facilities (Note 3).

Evaluation of Asset Impairment

We evaluate our real estate and finite-lived intangible assets for impairment each quarter. If there are indicators of impairment and we determine that the asset is not recoverable from future undiscounted cash flows

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PUBLIC STORAGE

NOTES TO FINANCIAL STATEMENTS

June 30, 2016

(Unaudited)

to be received through the asset's remaining life (or, if earlier, the expected disposal date), we record an impairment charge to the extent the carrying amount exceeds the asset's estimated fair value or net proceeds from expected disposal.

We evaluate our investments in unconsolidated real estate entities for impairment on a quarterly basis. We record an impairment charge to the extent the carrying amount exceeds estimated fair value, when we believe any such shortfall is other than temporary.

We evaluate goodwill for impairment annually and whenever relevant events, circumstances and other related factors indicate that fair value of the related reporting unit may be less than the carrying amount. If we determine that the fair value of the reporting unit exceeds the aggregate carrying amount, no impairment charge is recorded. Otherwise, we record an impairment charge to the extent the carrying amount of the goodwill exceeds the amount that would be allocated to goodwill if the reporting unit were acquired for estimated fair value.

We evaluate the "Shurgard" trade name for impairment at least annually and whenever relevant events, circumstances and other related factors indicate that the fair value is less than the carrying amount. When we conclude that it is likely that the asset is not impaired, we do not record an impairment charge and no further analysis is performed. Otherwise, we record an impairment charge to the extent the carrying amount exceeds the asset's estimated fair value.

No impairments were recorded in any of our evaluations for any period presented herein.

#### Revenue and Expense Recognition

Revenues from self-storage facilities, which is primarily composed of rental income earned pursuant to month-to-month leases for storage space, as well as associated late charges and administrative fees, are recognized as earned. Promotional discounts reduce rental income over the promotional period, which is generally one month. Ancillary revenues and interest and other income are recognized when earned. Equity in earnings of unconsolidated real estate entities represents our pro-rata share of the earnings of the Unconsolidated Real Estate Entities.

We accrue for property tax expense based upon actual amounts billed and, in some circumstances, estimates when bills or assessments have not been received from the taxing authorities. If these estimates are incorrect, the timing and amount of expense recognition could be incorrect. Cost of operations, general and administrative expense, interest expense, as well as advertising expenditures are expensed as incurred.

#### Foreign Currency Exchange Translation

The local currency (primarily the Euro) is the functional currency for our interests in foreign operations. The related balance sheet amounts are translated into U.S. Dollars at the exchange rates at the respective financial statement date, while amounts on our statements of income are translated at the average exchange rates during the respective



period. When financial instruments denominated in a currency other than the U.S. Dollar are expected to be settled in cash in the foreseeable future, the impact of changes in the U.S. Dollar equivalent are reflected in current earnings. The Euro was translated at exchange rates of approximately 1.110 U.S. Dollars per Euro at June 30, 2016 (1.091 at December 31, 2015), and average exchange rates of 1.129 and 1.106 for the three months ended June 30, 2016 and 2015, respectively, and an average exchange rate of 1.116 for the each of six month periods ended June 30, 2016 and 2015. Cumulative translation adjustments, to the extent not included in cumulative net income, are included in equity as a component of accumulated other comprehensive income (loss).

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NOTES TO FINANCIAL STATEMENTS

June 30, 2016

(Unaudited)

Comprehensive Income

Total comprehensive income represents net income, adjusted for changes in other comprehensive income (loss) for the applicable period. The aggregate foreign currency exchange gains and losses reflected on our statements of comprehensive income are primarily related to our investment in Shurgard Europe and our senior unsecured notes denominated in Euros.

Recent Accounting Pronouncements and Guidance

In May 2014, the FASB issued Accounting Standards Update (“ASU”) 2014-09, Revenue from Contracts with Customers, which requires revenue to be based upon the consideration expected from customers for promised goods or services. The new standard, effective on January 1, 2018, permits either the retrospective or cumulative effects transition method and allows for early adoption on January 1, 2017. We do not believe this standard will have a material impact on our results of operations or financial condition.

In February 2015, the FASB issued ASU 2015-02, Consolidation – Amendments to the Consolidation Analysis, which modifies (i) the criteria for and the analysis of the identification of consolidation of variable interest entities, particularly when fee arrangements and related party relationships are involved, and (ii) the consolidation analysis for partnerships. We adopted this standard effective January 1, 2016, which did not change the consolidation status of any entities in which we have an interest; however, certain entities began to be considered VIE’s as a result of the change.

In February 2016, the FASB issued ASU 2016-02, Leases, which amends the existing accounting standards for lease accounting, including requiring lessees to recognize most leases on their balance sheets and making targeted changes to lessor accounting. The new standard, effective on January 1, 2019, requires a modified retrospective transition approach for all leases existing at, or entered into after, the date of initial application, with an option to use certain transition relief and allows for early adoption on January 1, 2016. We have not yet determined whether this standard will have a material effect on our results of operations or financial condition.

In March 2016, the FASB issued ASU 2016-09, Improvements to Employee Share-Based Payment Accounting. We early adopted this standard effective January 1, 2016. Under this standard, a share-based compensation-related tax liability paid on behalf of employees in lieu of shares received is classified as a financing activity on the statement of cash flows, rather than as an operating activity as we had previously presented such amounts. We applied this provision retrospectively. The standard also allows a company to choose, with respect to recording share-based expense, between (i) recognizing forfeitures only as they occur or (ii) estimating future forfeitures in advance. We chose to recognize forfeitures only as they occur, rather than estimating in advance, accordingly, effective January 1, 2016, under the modified retrospective transition method as required by the standard, we recorded a cumulative-effect adjustment of \$0.8 million to increase accumulated deficit and increase paid-in capital for the impact of estimated future forfeitures after December 31, 2015 (Note 9).



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## NOTES TO FINANCIAL STATEMENTS

June 30, 2016

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## Net Income per Common Share

Net income is allocated to (i) noncontrolling interests based upon their share of the net income of the Subsidiaries, (ii) preferred shareholders, to the extent redemption cost exceeds the related original net issuance proceeds (an "EITF D-42 allocation"), and (iii) the remaining net income allocated to each of our equity securities based upon the dividends declared or accumulated during the period, combined with participation rights in undistributed earnings.

Basic and diluted per common share are each calculated based upon net income allocable to common shareholders presented on the face of our income statement, divided by (i) in the case of basic net income per common share, weighted average common shares, and (ii) in the case of diluted income per share, weighted average common shares adjusted for the impact, if dilutive, of stock options outstanding (Note 9). The following table reconciles from basic to diluted common shares outstanding:

		Three Months Ended		Six Months Ended	
		June 30,		June 30,	
		2016	2015	2016	2015

(Amounts in thousands)

## Weighted average common shares and equivalents outstanding:

Basic weighted average common shares outstanding	173,087	172,629	173,032	172,575
Net effect of dilutive stock options - based on treasury stock method	913	758	893	802
Diluted weighted average common shares outstanding	174,000	173,387	173,925	173,377

## 3.Real Estate Facilities

Activity in real estate facilities during the six months ended June 30, 2016 is as follows:

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## NOTES TO FINANCIAL STATEMENTS

June 30, 2016

(Unaudited)

	Six Months Ended June 30, 2016 (Amounts in thousands)
Operating facilities, at cost:	
Beginning balance	\$ 13,205,261
Capital expenditures to maintain real estate facilities	44,945
Acquisitions	185,150
Newly developed facilities opened for operation	136,989
Impact of foreign exchange rate changes	(1,685)
Ending balance	13,570,660
Accumulated depreciation:	
Beginning balance	(4,866,738)
Depreciation expense	(198,729)
Impact of foreign exchange rate changes	1,044
Ending balance	(5,064,423)
Construction in process:	
Beginning balance	219,190
Current development	145,902
Newly developed facilities opened for operation	(136,989)
Ending balance	228,103
Total real estate facilities at June 30, 2016	\$ 8,734,340

During the six months ended June 30, 2016, we acquired 24 self-storage facilities (1,703,000 net rentable square feet), for a total cost of \$197.6 million, consisting of \$184.7 million in cash and the assumption of \$12.9 million in mortgage debt. Approximately \$12.5 million of the total cost was allocated to intangible assets. We completed expansion and development activities during the six months ended June 30, 2016, adding 1,269,000 net rentable square feet of self-storage space, at an aggregate cost of \$137.0 million. Construction in process at June 30, 2016 consists of projects to develop new self-storage facilities and expand existing self-storage facilities, which would add a total of 4.9 million net rentable square feet of storage space, for an aggregate estimated cost of approximately \$630.7 million.

## 4. Investments in Unconsolidated Real Estate Entities

The following table sets forth our investments in, and equity earnings of, the Unconsolidated Real Estate Entities (amounts in thousands):

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NOTES TO FINANCIAL STATEMENTS

June 30, 2016

(Unaudited)

	Investments in Unconsolidated Real Estate Entities at	
	June 30, 2016	December 31, 2015
PSB	\$ 407,954	\$ 414,450
Shurgard Europe	281,674	388,367
Other Investments (A)	6,441	6,491
Total	\$ 696,069	\$ 809,308