

Edgar Filing: Public Storage - Form 10-Q

Public Storage  
Form 10-Q  
November 09, 2007

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, 2007

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

95-3551121

-----  
(State or other jurisdiction of incorporation or organization)

(I.R.S. Employer Identification Number)

701 Western Avenue, Glendale, California

91201-2349

-----  
(Address of principal executive offices)

-----  
(Zip Code)

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 is a large accelerated filer, an accelerated filer or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act.

Large Accelerated Filer  Accelerated Filer  Non-accelerated Filer

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 November 7, 2007:

Common Shares of beneficial interest, \$.10 par value per share - 170,559,969

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shares

## PUBLIC STORAGE

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PUBLIC STORAGE  
CONDENSED CONSOLIDATED BALANCE SHEETS  
(Amounts in thousands, except share data)

September 30,  
2007

-----  
(Unaudited)

ASSETS

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|   |    |             |
|---|----|-------------|
| Cash and cash equivalents.....          | \$ | 168,586     |
| Real estate facilities, at cost:        |    |             |
| Land.....                               |    | 2,997,585   |
| Buildings.....                          |    | 8,509,767   |
|   |    | -----       |
|   |    | 11,507,352  |
| Accumulated depreciation.....           |    | (2,034,014) |
|   |    | -----       |
|   |    | 9,473,338   |
| Construction in process.....            |    | 103,657     |
|   |    | -----       |
|   |    | 9,576,995   |
| Investment in real estate entities..... |    | 317,982     |
| Goodwill.....                           |    | 174,634     |
| Intangible assets, net.....             |    | 222,168     |
| Restricted cash.....                    |    | 20,844      |
| Other assets.....                       |    | 148,414     |
|   |    | -----       |
| Total assets.....                       | \$ | 10,629,623  |
|   |    | =====       |

LIABILITIES AND SHAREHOLDERS' EQUITY

|   |    |             |
|---|----|-------------|
| Borrowings on bank credit facilities.....   | \$ | -           |
| Notes payable.....  |    | 1,004,507   |
| Debt to joint venture partner.....  |    | 37,395      |
| Preferred stock called for redemption.....  |    | -           |
| Accrued and other liabilities.....  |    | 323,091     |
|   |    | -----       |
| Total liabilities.....  |    | 1,364,993   |
| Minority interest:  |    |             |
| Preferred partnership interests.....  |    | 325,000     |
| Other partnership interests.....  |    | 181,772     |
| Commitments and contingencies (Note 15)   |    |             |
| Shareholders' equity:   |    |             |
| Cumulative Preferred Shares of beneficial interest, \$0.01 par value,<br>100,000,000 shares authorized, 1,739,500 shares issued (in series) and<br>outstanding, (1,712,600 at December 31, 2006) at liquidation preference..... |    | 3,527,500   |
| Common Shares of beneficial interest, \$0.10 par value, 650,000,000 shares<br>authorized, 169,402,880 shares issued and outstanding (169,144,467 at<br>December 31, 2006).....  |    | 16,941      |
| Equity Shares of beneficial interest, Series A, \$0.01 par value,<br>100,000,000 shares authorized, 8,744.193 shares issued and outstanding..   |    | -           |
| Paid-in capital.....  |    | 5,652,304   |
| Cumulative net income.....  |    | 3,792,940   |
| Cumulative distributions paid.....  |    | (4,295,512) |
| Accumulated other comprehensive income.....   |    | 63,685      |
|   |    | -----       |
| Total shareholders' equity.....   |    | 8,757,858   |
|   |    | -----       |
| Total liabilities and shareholders' equity.....   | \$ | 10,629,623  |
|   |    | =====       |

See accompanying notes.

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CONDENSED CONSOLIDATED STATEMENTS OF INCOME  
(Amounts in thousands, except per share amounts)

(Unaudited)

|   | Three Months Ended<br>September 30, |            |
|---|-------------------------------------|------------|
|   | 2007                                | 2006       |
| <b>Revenues:</b>  |                                     |            |
| Self-storage rental income.....   | \$ 427,949                          | \$ 328,782 |
| Ancillary operating revenue.....  | 37,754                              | 29,827     |
| Interest and other income.....  | 3,257                               | 12,651     |
|   | 468,960                             | 371,260    |
| <b>Expenses:</b>  |                                     |            |
| Cost of operations (excluding depreciation and<br>amortization):  |                                     |            |
| Self-storage facilities.....  | 143,371                             | 109,106    |
| Ancillary operations.....   | 22,687                              | 18,514     |
| Depreciation and amortization.....  | 147,767                             | 113,463    |
| General and administrative.....   | 11,416                              | 36,242     |
| Interest expense.....   | 15,257                              | 9,323      |
|   | 340,498                             | 286,648    |
| Income from continuing operations before equity in<br>earnings of real estate entities, casualty gain, gain<br>on disposition of real estate investments, foreign<br>currency exchange gain (loss), income from derivatives<br>and minority interest in income..... | 128,462                             | 84,612     |
| Equity in earnings of real estate entities.....   | 3,424                               | 2,618      |
| Casualty gain .....   | -                                   | -          |
| Gain on disposition of real estate investments.....   | 92                                  | 756        |
| Foreign currency exchange gain (loss).....  | 30,384                              | (172)      |
| Income from derivatives, net.....   | 117                                 | 32         |
| Minority interest in income.....  | (8,304)                             | (8,590)    |
|   | 154,175                             | 79,256     |
| Income from continuing operations.....  | 154,175                             | 79,256     |
| Cumulative effect of a change in accounting principle.....  | -                                   | -          |
| Discontinued operations.....  | (1,409)                             | 1,925      |
|   | 152,766                             | 81,181     |
| Net income.....   | \$ 152,766                          | \$ 81,181  |
| <b>Net income allocation:</b>   |                                     |            |
| Allocable to preferred shareholders based on<br>distributions paid.....   | \$ 60,333                           | \$ 60,265  |
| Allocable to preferred shareholders based on redemptions.....   | -                                   | 21,643     |
| Allocable to Equity Shares, Series A.....   | 5,356                               | 5,356      |
| Allocable to common shareholders.....   | 87,077                              | (6,083)    |
|   | \$ 152,766                          | \$ 81,181  |
| <b>Net income (loss) per common share - basic</b>   |                                     |            |
| Continuing operations.....  | \$ 0.52                             | \$ (0.05)  |
| Discontinued operations.....  | (0.01)                              | 0.01       |

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|  |         |           |
|--|---------|-----------|
|  | \$ 0.51 | \$ (0.04) |
| Net income (loss) per common share - diluted   |         |           |
| Continuing operations.....   | \$ 0.52 | \$ (0.05) |
| Discontinued operations.....   | (0.01)  | 0.01      |
|  | \$ 0.51 | \$ (0.04) |
| Net income per depositary share representing Equity Shares, Series A (basic and diluted) ..... | \$ 0.61 | \$ 0.61   |
| Basic weighted average common shares outstanding.....  | 169,374 | 145,387   |
| Diluted weighted average common shares outstanding.....  | 170,085 | 145,387   |
| Weighted average Equity Shares, Series A (basic and diluted).....                              | 8,744   | 8,744     |

See accompanying notes.

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PUBLIC STORAGE  
CONDENSED CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY  
(Amounts in thousands, except share data)

(Unaudited)

|  | Cumulative<br>Preferred Shares | Common Shares | Pa |
|--|--------------------------------|---------------|----|
| Balance at December 31, 2006.....                        | \$ 2,855,000                   | \$ 16,915     | \$ |
| Issuance of cumulative preferred shares:                 |                                |               |    |
| Series M (20,000 shares).....                            | 500,000                        | -             |    |
| Series N (6,900 shares).....                             | 172,500                        | -             |    |
| Issuance of common shares in connection with:            |                                |               |    |
| Exercise of employee stock options (191,095 shares)...   | -                              | 19            |    |
| Vesting of restricted shares (67,318 shares) .....       | -                              | 7             |    |
| Stock-based compensation expense (Note 13) .....         | -                              | -             |    |
| Net income.....  | -                              | -             |    |
| Cash distributions:                                      |                                |               |    |
| Cumulative preferred shares (Note 11).....               | -                              | -             |    |
| Equity Shares, Series A (\$1.838 per depositary share).. | -                              | -             |    |
| Common Shares (\$1.50 per share).....                    | -                              | -             |    |
| Accumulated other comprehensive income:                  |                                |               |    |
| Foreign currency translation adjustments not reflected   |                                |               |    |

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|                                    |              |           |    |
|------------------------------------|--------------|-----------|----|
| in net income.....                 | -            | -         | -  |
| Balance at September 30, 2007..... | \$ 3,527,500 | \$ 16,941 | \$ |

PUBLIC STORAGE  
CONDENSED CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY  
(Amounts in thousands, except share data)

(Unaudited)

|  | Cumulative<br>Distributions | Accumulated<br>Other<br>Comprehensive<br>Income |
|--|-----------------------------|---|
| Balance at December 31, 2006.....  | \$ (3,847,998)              | \$ 19,329                                       |
| Issuance of cumulative preferred shares:                                     |                             |   |
| Series M (20,000 shares).....  | -                           | -   |
| Series N (6,900 shares).....   | -                           | -   |
| Issuance of common shares in connection with:                                |                             |   |
| Exercise of employee stock options (191,095 shares)...                       | -                           | -   |
| Vesting of restricted shares (67,318 shares) .....                           | -                           | -   |
| Stock-based compensation expense (Note 13) .....                             | -                           | -   |
| Net income.....  | -                           | -   |
| Cash distributions:  |                             |   |
| Cumulative preferred shares (Note 11).....                                   | (176,424)                   | -   |
| Equity Shares, Series A (\$1.838 per depository share)..                     | (16,068)                    | -   |
| Common Shares (\$1.50 per share).....  | (255,022)                   | -   |
| Accumulated other comprehensive income:                                      |                             |   |
| Foreign currency translation adjustments not reflected<br>in net income..... | -                           | 44,356  |
| Balance at September 30, 2007.....   | \$ (4,295,512)              | \$ 63,685                                       |

See accompanying notes.

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PUBLIC STORAGE  
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS  
(Amounts in thousands)

(Unaudited)

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For the Nine Months Ended  
September 30,

2007

Cash flows from operating activities:

|   |            |
|---|------------|
| Net income.....   | \$ 289,648 |
| Adjustments to reconcile net income to net cash provided by operating activities:                   |            |
| Amortization of note premium, net of increase in debt to joint venture partner (Notes 7 and 8)..... | (3,592)    |
| Gain on sales of real estate and real estate investments (Notes 4 and 14).....                      | (2,330)    |
| Depreciation and amortization.....  | 491,725    |
| Write off of capitalized development project costs.....   | 1,615      |
| Equity in earnings of real estate entities.....   | (10,183)   |
| Foreign currency exchange (gain) loss.....  | (40,977)   |
| Income from derivatives, net.....   | (1,126)    |
| Distributions received from the real estate entities (Note 5).....                                  | 17,185     |
| Minority interest in income.....  | 21,611     |
| Other operating activities.....   | (11,985)   |
| Total adjustments.....  | 461,943    |
| Net cash provided by operating activities.....  | 751,591    |

Cash flows from investing activities:

|   |           |
|---|-----------|
| Capital improvements to real estate facilities .....                  | (49,453)  |
| Construction in process.....  | (81,134)  |
| Acquisition of minority interests.....                                | -         |
| Acquisition of real estate facilities.....                            | (72,787)  |
| (Deconsolidation) consolidation of partnerships (Note 2).....         | (65)      |
| Cash portion of the merger with Shurgard (Note 3).....                | -         |
| Proceeds from sales of real estate.....                               | 2,008     |
| Sale of real estate investments to affiliates (Note 10).....          | 4,909     |
| Additions to restricted cash.....                                     | (944)     |
| Proceeds from sales of held-to-maturity debt securities (Note 2)..... | 6,019     |
| Net cash used in investing activities.....                            | (191,447) |

Cash flows from financing activities:

|   |           |
|---|-----------|
| Principal payments on notes payable.....  | (504,658) |
| Net repayments on bank credit facilities.....                                   | (345,000) |
| Contributions received from European minority interests.....                    | -         |
| Proceeds from borrowings on European notes payable.....                         | 39,602    |
| Net proceeds from the issuance of common shares.....                            | 8,052     |
| Net proceeds from the issuance of cumulative preferred shares.....              | 651,892   |
| Redemption of cumulative preferred shares.....                                  | (302,150) |
| Issuance of preferred partnership interests.....                                | -         |
| Distributions paid to shareholders.....   | (447,514) |
| Distributions paid to holders of preferred partnership interests (Note 10)..... | (16,209)  |
| Distributions paid to other minority interests.....                             | (15,828)  |
| Net cash used in financing activities.....                                      | (931,813) |

|   |           |
|---|-----------|
| Net decrease in cash and cash equivalents.....              | (371,669) |
| Net effect of foreign exchange translation on cash.....     | 4,571     |
| Cash and cash equivalents at the beginning of the year..... | 535,684   |

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Cash and cash equivalents at the end of the period..... \$ 168,586  
 =====

See accompanying notes.

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PUBLIC STORAGE  
 CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS  
 (Amounts in thousands)

(Unaudited)

(Continued)

Supplemental schedule of non-cash investing and financing activities:

Foreign currency translation adjustment:

|  |             |
|--|-------------|
| Real estate facilities, net of accumulated depreciation..... | \$ (99,305) |
| Construction in process.....                                 | (3,610)     |
| Intangible assets, net.....                                  | (14,718)    |
| Other assets.....  | (4,694)     |
| Notes payable.....   | 26,337      |
| Accrued and other liabilities.....                           | 7,094       |
| Minority interest - other partnership interests.....         | 8,134       |
| Accumulated other comprehensive income (loss).....           | 85,333      |

Deconsolidation of real estate entities:

|  |          |
|--|----------|
| Real estate facilities, net of accumulated depreciation..... | 41,409   |
| Investment in real estate entities.....                      | (23,079) |
| Intangible assets, net.....                                  | 1,816    |
| Other assets.....  | 344      |
| Notes payable.....   | (19,329) |
| Accrued and other liabilities.....                           | (544)    |
| Minority interests .....                                     | (682)    |

|  |   |
|--|---|
| Real estate acquired in exchange for assumption of mortgage note.....    | - |
| Mortgage note assumed in connection with acquisition of real estate..... | - |

Merger with Shurgard Storage Centers, Inc.:

|                                    |   |
|------------------------------------|---|
| Real estate facilities.....        | - |
| Intangible assets.....             | - |
| Other assets.....                  | - |
| Accrued and other liabilities..... | - |
| Minority interest.....             | - |
| Debt.....                          | - |
| Common stock.....                  | - |
| Paid in capital.....               | - |

Consolidation of entities pursuant to Emerging Issues Task Force Topic 04-5:

|  |   |
|--|---|
| Minority interest - other partnership interests..... | - |
| Real estate facilities.....                          | - |
| Investments in real estate entities.....             | - |
| Other assets.....                                    | - |
| Accrued and other liabilities.....                   | - |



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Revaluation of debt to joint venture partner:

Debt due to joint venture partner..... -  
Other assets..... -

See accompanying notes.

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PUBLIC STORAGE  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
September 30, 2007  
(Unaudited)

1. Description of the Business  
-----

Public Storage, Inc., formerly a California corporation, was organized in 1980. Effective June 1, 2007, following approval by our shareholders, we reorganized Public Storage, Inc. into Public Storage, a Maryland real estate investment trust (referred to herein as "the Company", "the Trust", "we", "us", or "our"). We are a fully integrated, self-administered and self-managed real estate investment trust ("REIT") whose principal business activities include the acquisition, development, 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. Our self-storage facilities are located primarily in the United States. As a result of the merger with Shurgard Storage Centers, Inc. ("Shurgard") on August 22, 2006, we also have self-storage facilities located in seven Western European countries (Note 3).

In addition to our self-storage facilities, we own (i) interests in commercial properties containing commercial and industrial rental space, (ii) interests in facilities that lease storage containers, and (iii) other ancillary operations conducted at our self-storage locations comprised principally of reinsurance of policies against losses to goods stored by our self-storage tenants, retail sales of storage related products and truck rentals.

At September 30, 2007, we had direct and indirect equity interests in 2,012 self-storage facilities located in 38 states operating under the "Public Storage" name, and 169 self-storage facilities located in Europe which operate under the "Shurgard Storage Centers" name. We also have direct and indirect equity interests in approximately 20 million net rentable square feet of commercial space located in 11 states in the United States.

Any reference to the number of properties, square footage, number of tenant reinsurance policies outstanding and the aggregate coverage of such reinsurance policies 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 (United States).

2. Summary of Significant Accounting Policies  
-----

Basis of Presentation  
-----

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The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles ("GAAP") for interim financial information and the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and notes required by GAAP for complete financial statements. In the opinion of management, all adjustments (consisting of normal and recurring adjustments) considered necessary for a fair presentation have been reflected in these unaudited condensed consolidated financial statements. Operating results for the three and nine months ended September 30, 2007 are not necessarily indicative of the results that may be expected for the year ended December 31, 2007. The accompanying unaudited condensed consolidated financial statements should be read together with the consolidated financial statements and related notes included in the Company's Annual Report on Form 10-K (and amendments thereto) for the year ended December 31, 2006.

Certain amounts previously reported have been reclassified to conform to the September 30, 2007 presentation. In previous presentations, certain cash balances held by our captive insurance entities which are restricted as to their use were included in cash and cash equivalents on the Company's condensed consolidated balance sheets. These restricted balances are reclassified as "restricted cash" (see also "Restricted Cash" below). In previous presentations, revenues and cost of operations with respect to our Commercial facilities and Containerized Storage facilities

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PUBLIC STORAGE  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
September 30, 2007  
(Unaudited)

were reported on separate lines on our condensed consolidated statements of income. In our current presentation, revenues with respect to each of these operations, along with revenues from our tenant reinsurance, retail, truck and property management operations, are included under the caption "Revenues: Ancillary operations" and the related cost of operations are included in "Expenses: Cost of operations - Ancillary operations" on our accompanying condensed consolidated statements of income. Certain reclassifications have also been made from previous presentations as a result of discontinued operations.

#### Consolidation Policy

-----

Entities in which we have an interest are first evaluated to determine whether, in accordance with the provisions of the Financial Accounting Standards Board's Interpretation No. 46R, "Consolidation of Variable Interest Entities," they represent Variable Interest Entities ("VIE's"). VIE's in which we are the primary beneficiary are consolidated. Entities that are not VIE's that we control are consolidated.

For purposes of determining control, when we are the general partner, we are considered to control the partnership unless the limited partners possess substantial "kick-out" or "participative" rights as defined in Emerging Issues Task Force Statement 04-5 - "Determining whether a general partner or the general partners as a group, controls a limited partnership or similar entity when the limited partners have certain rights" ("EITF 04-5"). All significant intercompany balances and transactions have been eliminated.

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The accounts of the entities we control along with the accounts of the VIE's that we are the primary beneficiary of are included in our consolidated financial statements along with those of the Company. We account for our investment in entities that we do not control, or entities for which we are not the primary beneficiary and over which we have significant influence, using the equity method of accounting. Changes in consolidation status are reflected effective the date the change of control or determination of primary beneficiary status occurred, and previously reported periods are not restated. The entities that we consolidate during the periods to which the reference applies, are referred to hereinafter as the "Consolidated Entities." The entities that we have an interest in but do not consolidate during the periods to which the reference applies, are referred to hereinafter as the "Unconsolidated Entities."

Collectively, at September 30, 2007, the Company and the Consolidated Entities own a total of 2,157 real estate facilities, consisting of 1,979 self-storage facilities in the United States, 169 facilities in Europe, three industrial facilities used by the containerized storage operations and six commercial properties.

At September 30, 2007, the Unconsolidated Entities are comprised of our equity investments in various limited and joint venture partnerships owning an aggregate of 33 self-storage facilities, as well as our ownership of approximately 44% of the common equity of PS Business Parks, Inc. ("PSB"), which has interests in approximately 19.6 million net rentable square feet of commercial space at September 30, 2007.

### Deconsolidation of Certain Entities

-----

On May 24, 2007, a judgment was rendered which resulted in our losing effective control over several entities in which we had acquired an interest in connection with the acquisition of Shurgard Storage Centers. These entities owned 11 facilities with approximately 624,000 net rentable square feet at September 30, 2007. Because of our loss of control, we discontinued consolidation of these entities and therefore began to account for them on the equity method, effective the date of the judgment. Notwithstanding our loss of control, we continue to retain all of our previous financial interests in these partnerships.

The deconsolidation of these entities resulted in an increase in Investment in Real Estate Entities of \$23,079,000, and adjustments to the following balance sheet accounts, representing the balance sheet amounts of these entities:

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PUBLIC STORAGE  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
September 30, 2007  
(Unaudited)

|                             | Total       |
|-----------------------------|-------------|
|                             | -----       |
| Real estate facilities, net | \$ (41,409) |
| Intangible assets.....      | (1,816)     |
| Cash.....                   | (65)        |
| Other assets.....           | (344)       |
| Debt.....                   | 19,329      |

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|                               |             |
|-------------------------------|-------------|
| Accrued and other liabilities | 544         |
| Minority interest .....       | 682         |
|                               | -----       |
|                               | \$ (23,079) |
|                               | =====       |

### Use of Estimates

-----

The preparation of the consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Actual results could differ from those estimates.

### Income Taxes

-----

For all taxable years subsequent to 1980, the Company qualified and intends to continue to qualify as a REIT, as defined in Section 856 of the Internal Revenue Code. As a REIT, we do not incur federal or significant state tax on that portion of our taxable income which is distributed to our shareholders, provided that we meet certain tests. We believe we will meet these tests during 2007 and, accordingly, no provision for income taxes has been made in the accompanying condensed consolidated financial statements on income produced and distributed on real estate rental operations.

### Financial Instruments

-----

We have estimated the fair value of our financial instruments using available market information and appropriate valuation methodologies. Considerable judgment is required in interpreting market data to develop estimates of market value. Accordingly, estimated fair values are not necessarily indicative of the amounts that could be realized in current market exchanges.

For purposes of financial statement presentation, we consider all highly liquid financial instruments such as short-term treasury securities or investment grade short-term commercial paper to be cash equivalents.

Due to the short period to maturity of our cash and cash equivalents, accounts receivable, other financial instruments included in other assets, and accrued and other liabilities, the carrying values as presented on the consolidated balance sheets are reasonable estimates of fair value.

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PUBLIC STORAGE  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
September 30, 2007  
(Unaudited)

Financial assets that are exposed to credit risk consist primarily of cash and cash equivalents and accounts receivable. Cash and cash equivalents, consisting of short-term investments, including commercial paper, are only invested in entities with an investment grade rating. Accounts receivable are not a significant portion of total assets and are comprised of a large number of small individual customer balances.

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Due to the acquisition of European subsidiaries in the merger with Shurgard, the results of our operations and our financial position are affected by the fluctuations in the value of the euro, and to a lesser extent, other European currencies, against the U.S. dollar.

Other assets at September 30, 2007 include investments totaling \$745,000 (\$6,764,000 at December 31, 2006) representing held-to-maturity Federal government agency securities stated at amortized cost, which approximates fair value. Other assets at September 30, 2007 also include derivative financial instruments totaling \$5,660,000 (\$11,810,000 at December 31, 2006) reported at estimated fair value. See Note 9 for further discussion of the fair value of our derivative financial instruments.

### Restricted Cash

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Restricted cash at September 30, 2007 and December 31, 2006, consists of cash held by our captive insurance entities which, due to insurance and other regulations with respect to required reserves and minimum capital requirements, can only be utilized to pay captive claims.

### Real Estate Facilities

-----

Real estate facilities are recorded at cost. Costs associated with the acquisition, development, construction, renovation, and improvement of properties are capitalized. Interest, property taxes, and other costs associated with development incurred during the construction period are capitalized as building cost. Costs associated with the sale of real estate facilities or interests in real estate investments are expensed as incurred. Expenditures for repairs and maintenance are charged to expense when incurred. Depreciation is computed using the straight-line method over the estimated useful lives of the buildings and improvements, which are generally between 5 and 25 years.

### Evaluation of Asset Impairment

-----

We evaluate impairment of goodwill annually through a two-step process. In the first step, if the fair value of the reporting unit to which the goodwill applies is equal to or greater than the carrying amount of the assets of the reporting unit, including the goodwill, the goodwill is considered unimpaired and the second step is unnecessary. If, however, the fair value of the reporting unit including goodwill is less than the carrying amount, the second step is performed. In this test, we compute the implied fair value of the goodwill based upon the allocations that would be made to the goodwill, other assets and liabilities of the reporting unit if a business combination transaction were consummated at the fair value of the reporting unit. An impairment loss is recorded to the extent that the implied fair value of the goodwill is less than the goodwill's carrying amount. No impairments of our goodwill were identified in our annual evaluation at December 31, 2006.

We evaluate impairment of long-lived assets on a quarterly basis. We first evaluate these assets for indicators of impairment such as a) a significant decrease in the market price of a long-lived asset, b) a significant adverse change in the extent or manner in which a long-lived asset is being used or in its physical condition, c) a significant adverse change in legal factors or the business climate that could affect the value of the long-lived asset, d) an accumulation of costs significantly in excess of the amount originally projected for the acquisition or construction of the long-lived asset, or e) a current-period operating or

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cash flow loss combined with a history of operating or cash flow losses or a projection or forecast that demonstrates continuing losses associated with the use of the long-lived asset. When any such indicators of impairment are noted, we compare the carrying value of these assets to the future estimated undiscounted cash flows attributable to these assets. If the asset's recoverable amount is less than the carrying value of the asset, then an impairment charge is booked for the excess of carrying value over the asset's fair value.

Any long-lived assets which we expect to sell or otherwise dispose of prior to their previously estimated useful life are stated at what we estimate to be the lower of their estimated net realizable value (less cost to sell) or their carrying value. No impairment was identified from our evaluations as of September 30, 2007.

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### Accounting for Stock-Based Compensation

-----

We utilize the Fair Value Method (as defined in Note 13) of accounting for our employee stock options. Restricted share unit expense is recorded over the relevant vesting period. See Note 13 for a discussion of our accounting with respect to employee share options and restricted share units.

### Other Assets

-----

Other assets primarily consists of prepaid expenses, investments in held-to-maturity debt securities, accounts receivable, assets associated with our containerized storage business, merchandise inventory and rental trucks. Included in other assets is approximately \$61 million and \$65 million at September 30, 2007 and December 31, 2006, respectively, from our European operations.

### Accrued and Other Liabilities

-----

Accrued and other liabilities consist primarily of real property tax accruals, value-added tax accruals with respect to our European operations, prepayments of rents, trade payables, losses and loss adjustment liabilities for our self-insured risks (described below), and accrued interest. Prepaid rent totaled \$65,154,000 at September 30, 2007 (\$64,291,000 at December 31, 2006), while property and value-added tax accruals approximated \$110,077,000 at September 30, 2007 (\$80,336,000 at December 31, 2006).

We are self-insured for a portion of the risks associated with our property and casualty losses, workers compensation, and employee health care. We also utilize third-party insurance carriers to limit our self insurance exposure. We accrue liabilities for uninsured losses and loss adjustment expense, which at September 30, 2007 totaled \$33,931,000 (\$31,532,000 at December 31, 2006). Liabilities for losses and loss adjustment expenses include an amount we determine from loss reports and individual cases and an amount, based on recommendations from an

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independent actuary that is a member of the American Academy of Actuaries using a frequency and severity method, for losses incurred but not reported. Determining the liability for unpaid losses and loss adjustment expense is based upon estimates.

Through a wholly-owned subsidiary, we reinsure policies against claims for losses to goods stored by tenants in our self-storage facilities. For our United States operations, we have third-party insurance coverage for losses from any individual event that exceeds a loss of \$1,500,000, to a maximum of \$9,000,000. Estimated uninsured losses are accrued as ancillary costs of operations.

While we believe that the amount of estimated accrued liabilities with respect to tenant claims, property, casualty, workers compensation, and employee healthcare are adequate, the ultimate losses that are actually paid may be different than what we have accrued. The methods for making such estimates and for establishing the resulting liabilities are regularly reviewed.

Included in accrued and other liabilities is \$91,783,000 and \$108,331,000 at September 30, 2007 and December 31, 2006, respectively, from our European operations.

### Goodwill and Intangible Assets

-----

Goodwill represents the excess of acquisition cost over the fair value of net tangible and identifiable intangible assets acquired in business combinations. Each business combination from which our goodwill arose was for the acquisition of single businesses and accordingly, the

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allocation of our goodwill to our business segments (principally Domestic Self-Storage) is based directly on such acquisitions. Our goodwill has an indeterminate life in accordance with the provisions of Statement of Financial Accounting Standards No. 142 ("SFAS 142").

As a result of the merger with Shurgard (Note 3), we acquired finite-lived intangible assets comprised primarily of tenant intangibles valued at \$565,341,000 and the "Shurgard" tradename, which we continue to use in Europe, valued at \$18,824,000. Our intangible assets were increased by \$14,718,000 during the nine months ended September 30, 2007 due to the impact of changes in exchange rates. During the nine months ended September 30, 2007, our intangible assets increased \$5,135,000 for storage tenants in place with respect to self-storage facility acquisitions. Also during the nine months ended September 30, 2007, our intangible assets decreased \$1,816,000 in connection with the deconsolidation of our investment in certain real estate entities (Note 5). Our finite-lived intangible assets are reported net of accumulated amortization of \$386,415,000 as of September 30, 2007 (\$175,944,000 as of December 31, 2006).

The tenant intangible assets are amortized relative to the expected benefit of the tenants in place to each period and relative to the benefit of the below-market leases. The Shurgard tradename has an indefinite life and, accordingly, we do not amortize this asset but instead

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analyze it on an annual basis for impairment.

Amortization expense of \$53,320,000 and \$210,471,000 was recorded for our finite-lived intangible assets for the three and nine months ended September 30, 2007, respectively. The estimated annual amortization expense for our finite-lived intangible assets for the current year and each of the next four years ending December 31 is as follows:

|                     |    |            |
|---------------------|----|------------|
| 2007 (remainder of) | \$ | 37,757,000 |
| 2008                |    | 79,838,000 |
| 2009                |    | 27,409,000 |
| 2010                |    | 16,418,000 |
| 2011                |    | 12,644,000 |
| 2012 and beyond     |    | 29,278,000 |

### Revenue and Expense Recognition

-----

Rental income, which is generally earned pursuant to month-to-month leases for storage space, is recognized as earned. Promotional discounts are recognized as a reduction to rental income over the promotional period, which is generally during the first month of occupancy. Late charges and administrative fees are recognized as income when collected. Tenant reinsurance premiums are recognized as premium revenue when earned. Revenues from merchandise sales and truck rentals are recognized when earned. Interest income is recognized as earned. Equity in earnings of real estate entities is recognized based on our ownership interest in the earnings of each of the Unconsolidated Entities.

We accrue for property tax expense based upon estimates and historical trends. If these estimates are incorrect, the timing and amount of expense recognition could be affected.

Cost of operations, general and administrative expense, interest expense, as well as television, yellow page, and other advertising expenditures are expensed as incurred.

During the second quarter of 2007, a share offering of Shurgard Europe, our European operations, was initiated to be listed on EuronextTM Brussels. Due to adverse market conditions, this offering was withdrawn on June 21, 2007. There is no estimate as to when or if a future offering may occur. We incurred \$9.5 million in expenses related to the proposed offering of shares which is included in general and administrative expense for the nine months ended September 30, 2007.

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### Foreign Exchange Translation

-----

The local currency is the functional currency for our European subsidiaries. Assets and liabilities (other than for intercompany balances, which are discussed below) are translated at end-of-period exchange rates while revenues and expenses are translated at the average exchange rates in effect during the period. The Euro was translated at an end-of-period



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exchange rate of approximately 1.426 in U.S. dollars per Euro at September 30, 2007 (1.319 at December 31, 2006). Equity is translated at historical rates and the resulting cumulative translation adjustments, to the extent not included in net income, are included as a component of accumulated other comprehensive income (loss) until the translation adjustments are realized. Included in other accumulated comprehensive income was a cumulative foreign currency translation adjustment gain of \$63,685,000 at September 30, 2007 (\$19,329,000 at December 31, 2006).

With respect to intercompany balances among our European subsidiaries and our domestic operations, when settlement of such intercompany balances are not expected in the near term (generally within one to two years), the impact of end-of-period exchange rate changes on the expected settlement amounts in U.S. Dollars are reflected in accumulated other comprehensive income (loss). However, for any other intercompany balances where settlement is expected in the foreseeable future, changes in exchange rates are recorded in income in the period in which the change occurs. For the three and nine months ended September 30, 2007, we recorded foreign currency exchange gains of \$30,384,000 and \$40,977,000, respectively, on our condensed consolidated statements of income, principally related to such intercompany balances. Substantially all of such intercompany balances are expected to settle in the foreseeable future. At September 30, 2007 and December 31, 2006, our European subsidiaries had intercompany balances payable to our United States operations totaling \$556,186,000 and \$542,162,000, respectively.

### Accounting for Casualty Losses

-----

Our policy is to record casualty losses or gains in the period the casualty occurs equal to the differential between (a) the book value of assets destroyed and (b) insurance proceeds, if any, that we expect to receive in accordance with our insurance contracts. Potential insurance proceeds that are subject to uncertainties, such as interpretation of deductible provisions of the governing agreements or the estimation of costs of restoration, are treated as contingent proceeds in accordance with Statement of Financial Accounting Standards No. 5 ("SFAS 5"), and not recorded until the uncertainties are satisfied. During the first quarter of 2007, we recorded a casualty gain totaling \$2,665,000, representing the realization of such contingent proceeds relating to hurricanes which occurred in 2005.

### Derivative Financial Instruments

-----

We have certain derivative financial instruments held by our two joint ventures in Europe, including interest rate caps, interest rate swaps, cross-currency swaps and foreign currency forward contracts. These derivatives were entered into by the joint ventures in order to mitigate currency and exchange rate fluctuation risk in connection with European borrowings, and are not for speculative or trading purposes.

In accordance with the provisions of Statement of Financial Accounting Standards No. 133, Accounting for Derivative Financial Instruments and Hedging Activities ("SFAS 133"), derivative financial instruments are measured at fair value and recognized on the balance sheet as assets or liabilities.

As of September 30, 2007, none of the derivatives were considered effective hedges because we believe it is not highly likely that the debt and the related derivative instruments will remain outstanding for their entire contractual period. Accordingly, all changes in the fair values of

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the derivatives are reflected in earnings, along with the related cash flows from these instruments, under "Income from derivatives, net" on our condensed consolidated statements of income.

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Other Comprehensive Income  
-----

Our comprehensive income is as follows (amounts in thousands):

|   | For the Three Months Ended<br>September 30, |           | For the Nine<br>Months Ended<br>September 30, |
|---|---|-----------|---|
|   | 2007  | 2006      | 2007  |
| Net income.....   | \$ 152,766                                  | \$ 81,181 | \$ 289,648                                    |
| Accumulated other comprehensive income<br>(loss):                           |   |           |   |
| Aggregate foreign currency translation<br>adjustments.....                  | 58,396                                      | (11,269)  | 85,333  |
| Less: foreign currency translation<br>adjustments reflected in net income.. | (30,384)                                    | -         | (40,977)                                      |
| Total comprehensive income.....   | \$ 180,778                                  | \$ 69,912 | \$ 334,004                                    |
|   | \$ 180,778                                  | \$ 69,912 | \$ 334,004                                    |

Other comprehensive income reflects our net income, adjusted for any portion of currency translation adjustments related to our European subsidiaries measured from the beginning to the end of each respective period, which have already been reflected in our net income.

Environmental Costs  
-----

Our policy is to accrue environmental assessments and estimated remediation costs when it is probable that such efforts will be required and the related costs can be reasonably estimated. Our current practice is to conduct environmental investigations in connection with property acquisitions. Although there can be no assurance, we are not aware of any environmental contamination of our facilities, which individually or in the aggregate would be material to our overall business, financial condition, or results of operations.

Discontinued Operations  
-----

We segregate all of our disposed components that have operations that can be distinguished from the rest of the Company and will be eliminated from the ongoing operations of the Company in a disposal transaction. Discontinued operations principally consists of the historical

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operations related to facilities that were closed and are no longer in operation and facilities that have been disposed of either through condemnation by a local governmental agency or sale. In the three and nine months ended September 30, 2007, loss from discontinued operations totaled \$1,409,000 and \$3,238,000, respectively, as compared to net income totaling \$1,925,000 and \$1,558,000, respectively for the same periods in 2006.

### Net Income per Common Share

-----

In computing net income allocated to our common shareholders, we first allocate net income to our preferred shareholders. Distributions paid to the holders of our Cumulative Preferred Shares totaling \$60,333,000 and \$176,424,000 for the three and nine months ended September 30, 2007, respectively, and \$60,265,000 and \$159,256,000 for the three and nine months ended September 30, 2006, respectively, have been deducted from net income to arrive at net income allocable to our common shareholders.

When we call any of our Cumulative Preferred Shares for redemption, we record an additional allocation of income to our preferred

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shareholders equal to the excess of a) the cash required to redeem the securities over b) the "Book Value" (the net proceeds from the original issuance of the securities) of the securities. An additional allocation of \$21,643,000 was recorded for the three and nine months ended September 30, 2006.

The remaining income allocated to our common shareholders has been further allocated among our regular common shares and our Equity Shares, Series A. The allocation among each class was based upon the two-class method. Under the two-class method, earnings per share for each class of common shares are determined according to dividends declared (or accumulated) and participation rights in undistributed earnings. Under the two-class method, the Equity Shares, Series A, were allocated net income of \$5,356,000 and \$16,068,000 for each of the three and nine months ended September 30, 2007 and 2006, respectively. Income of \$87,077,000 and \$97,156,000 for the three and nine months ended September 30, 2007, respectively, and loss of \$6,083,000 and income of \$127,292,000 for the three and nine months ended September 30, 2006, respectively, was allocated to the regular common shareholders.

Basic net income per share is computed using the weighted average common shares outstanding (prior to the dilutive impact of stock options and restricted share units outstanding). Diluted net income per common share is computed using the weighted average common shares outstanding (adjusted for the impact if dilutive, of stock options and restricted share units outstanding). Weighted average common shares excludes shares owned by the Consolidated Entities as described in Note 11 for all periods presented, as these common shares are eliminated in consolidation.

### Recently Issued Accounting Standards

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### The Fair Value Option for Financial Assets and Financial ----- Liabilities -----

In February 2007, the Financial Accounting Standards Board (the "FASB") issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities, including an amendment of FASB Statement No. 115" ("SFAS No. 159"). SFAS No. 159 provides companies with an option to report selected financial assets and liabilities at fair value. The standard establishes presentation and disclosure requirements designed to facilitate comparisons between companies that choose different measurement attributes for similar types of assets and liabilities. SFAS No. 159 is effective as of the beginning of an entity's first fiscal year beginning after November 15, 2007. We do not expect the adoption of SFAS No. 159 to have a material impact on our financial condition or results of operations.

### Accounting for Uncertainty in Income Taxes -----

In July 2006, the FASB issued Interpretation No. 48, "Accounting for Uncertainty in Income Taxes" ("FIN 48"). This interpretation, among other things, creates a two step approach for evaluating uncertain tax positions. Recognition (step one) occurs when an enterprise concludes that a tax position, based solely on its technical merits, is more-likely-than-not to be sustained upon examination. Measurement (step two) determines the amount of benefit that more-likely-than-not will be realized upon settlement. Derecognition of a tax position that was previously recognized would occur when a company subsequently determines that a tax position no longer meets the more-likely-than-not threshold of being sustained. FIN 48 specifically prohibits the use of a valuation allowance as a substitute for derecognition of tax positions, and it has expanded disclosure requirements. FIN 48 was effective for fiscal years beginning after December 15, 2006, in which the impact of adoption should be accounted for as a cumulative-effect adjustment to the beginning balance of retained earnings. We adopted the provisions of FIN 48 as of January 1, 2007. The adoption of FIN 48 had no material impact on our financial position, operating results or cash flows. See Note 16 for further discussion of our adoption of FIN 48.

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### Fair Value Measurement -----

In 2006, the FASB issued SFAS No. 157, "Fair Value Measurement" (SFAS No. 157). SFAS No. 157 provides guidance for using fair value to measure assets and liabilities. The standard expands required disclosures about the extent to which companies measure assets and liabilities at fair value, the information used to measure fair value, and the effect of fair value measurements on earnings. SFAS No. 157 applies whenever other standards require (or permit) assets or liabilities to be measured at fair value. SFAS No. 157 does not expand the use of fair value in any new circumstances. SFAS No. 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. We do not expect the impact to be material to

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our financial condition or results of operations.

### 3. Merger with Shurgard

-----

On August 22, 2006, we merged with Shurgard, a REIT which had interests in 487 self-storage facilities in the United States and 160 self-storage facilities in Europe.

Shurgard shareholders received 0.82 shares of Public Storage, Inc. common stock for each share of Shurgard common stock they owned. Total consideration for the merger was approximately \$5,323,956,000.

The results of operations of the facilities acquired from Shurgard have been included in our consolidated financial statements since the merger date of August 22, 2006.

### 4. Real Estate Facilities

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Activity in real estate facilities is as follows:

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|  | Nine Months Ended<br>September 30, 2007 |
|--|---|
|  | (Amounts in<br>thousands)               |
| Real estate facilities, at cost:                     |   |
| Balance at December 31, 2006.....                    | \$ 11,261,865                           |
| Newly developed facilities opened for operations.... | 71,125                                  |
| Acquisition of real estate facilities.....           | 67,652                                  |
| Deconsolidation of Entities (Note 2) .....           | (42,473)                                |
| Disposition of real estate facilities.....           | (1,239)                                 |
| Capital improvements.....                            | 49,453                                  |
| Impact of foreign exchange rate changes.....         | 100,969                                 |
|  | 11,507,352                              |
| Accumulated depreciation:                            |   |
| Balance at December 31, 2006.....                    | (1,754,362)                             |
| Deconsolidation of Entities (Note 2) .....           | 1,064                                   |
| Additions during the year.....                       | (279,420)                               |
| Dispositions during the year.....                    | 368                                     |
| Impact of foreign exchange rate changes.....         | (1,664)                                 |
|  | (2,034,014)                             |
| Construction in process:                             |   |
| Balance at December 31, 2006.....                    | 90,038                                  |
| Current development.....                             | 81,134                                  |
| Newly developed facilities opened for operations.... | (71,125)                                |
| Impact of foreign exchange rate changes.....         | 3,610                                   |
|  | 93,657                                  |

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|   |              |
|---|--------------|
| Balance at September 30, 2007.....                      | 103,657      |
|   | -----        |
| Total real estate facilities at September 30, 2007..... | \$ 9,576,995 |
|   | =====        |

During the nine months ended September 30, 2007, we completed six development and seven expansion projects which in aggregate added approximately 614,000 net rentable square feet of self-storage space at a total cost of \$71,125,000. In addition, we acquired seven self-storage facilities (511,000 net rentable square feet) from third parties for an aggregate cost of \$72,787,000, in cash; \$67,652,000 was allocated to real estate facilities and \$5,135,000 was allocated to intangibles, based upon the estimated relative fair values of the land, buildings and intangibles.

Construction in process at September 30, 2007 includes 39 projects in the United States (1,711,000 net rentable square feet), consisting of newly developed self-storage facilities, conversion of space at facilities that was previously used for containerized storage and expansions to existing self-storage facilities, with costs incurred of \$43,579,000 at September 30, 2007 and total estimated costs to complete of \$106,878,000. In addition, we have 16 projects to develop new self-storage facilities in Europe (793,000 aggregate net rentable square feet), with costs incurred at September 30, 2007 of \$60,078,000 and total estimated costs to complete of \$84,184,000.

We capitalize interest incurred on debt during the course of construction of our self-storage facilities. Interest capitalized for the three and nine months ended September 30, 2007 was \$1,297,000 and \$3,011,000, respectively, as compared to \$530,000 and \$1,599,000 for the same periods in 2006.

During the nine months ended September 30, 2007, we have received proceeds for partial condemnations and other disposals to certain of our self-storage facilities for an aggregate of \$2,008,000 and recorded a gain

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of \$1,137,000 as a result of these transactions. In connection with the sale of limited liability partner interests in Shurgard Europe (Note 10), we also recorded a gain of \$1,193,000 for the three and nine months ended September 30, 2007, representing the excess of the sales proceeds less the book value of the interests sold. The gain is reflected in gain on disposition of real estate investments on our accompanying condensed consolidated statements of income.

Included in real estate facilities, accumulated depreciation, and construction in process is \$1.6 billion with respect to our European operations at September 30, 2007.

5. Investment in Real Estate Entities  
-----

Interests in entities for periods that they are either VIE's that we are not the primary beneficiary of, or other non-VIE entities that we do not have a controlling financial interest in, are accounted for using the equity method of accounting. At September 30, 2007, our investments in real

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estate entities consist of ownership interests in the Unconsolidated Entities.

For the three and nine months ended September 30, 2007, we recognized earnings from our investments in real estate entities of \$3,424,000 and \$10,183,000, respectively, as compared to \$2,618,000 and \$9,208,000 for the same periods in 2006.

We received cash distributions from our investments in real estate entities for the nine months ended September 30, 2007 and 2006, of \$17,185,000 and \$15,049,000, respectively.

During the nine months ended September 30, 2007, our investments in real estates entities increased \$23,079,000 due to the deconsolidation of certain entities we had acquired an interest in, in connection with the merger with Shurgard. See Note 2 for further information.

The following table sets forth our investments in real estate entities at September 30, 2007 and December 31, 2006, and our equity in earnings of real estate entities for the three and nine months ended September 30, 2007 and 2006 (amounts in thousands):

|                        | Investments in Real Estate<br>Entities at |                      | Equity in Earnings of Real<br>Estate Entities for the Three<br>Months Ended Septembe 30, |                 |
|------------------------|---|----------------------|--|-----------------|
|                        | September 30,<br>2007                     | December 31,<br>2006 | 2007   | 2006            |
| PSB.....               | \$ 277,049                                | \$ 283,700           | \$ 2,522   | \$ 2,018        |
| Other Investments..... | 40,933                                    | 18,205               | 902  | 600             |
| <b>Total.....</b>      | <b>\$ 317,982</b>                         | <b>\$ 301,905</b>    | <b>\$ 3,424</b>  | <b>\$ 2,618</b> |

### Investment in PSB

PS Business Parks, Inc. is a REIT traded on the American Stock Exchange, which controls an operating partnership (collectively, the REIT and the operating partnership are referred to as "PSB"). We have a 44% common equity interest in PSB as of September 30, 2007. This common equity interest is comprised of our ownership of 5,418,273 shares of PSB's common stock and 7,305,355 limited partnership units in the operating partnership at both September 30, 2007 and December 31, 2006; these limited partnership units are convertible at our option, subject to certain conditions, on a one-for-one basis into PSB common stock. Based upon the closing price at September 30, 2007 (\$56.85 per share of PSB common stock), the shares and units had a market value of approximately \$723.3 million as compared to a book value of \$277.0 million.

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At September 30, 2007, PSB owned approximately 19.6 million net rentable square feet of commercial space. In addition, PSB manages commercial space owned by the Company and the Consolidated Entities pursuant to property management agreements.

The following table sets forth selected financial information of PSB; the amounts represent 100% of PSB's balances and not our pro-rata share.

|   | 2007       | 2006       |
|---|------------|------------|
| -----   |            |            |
| (Amounts in thousands)                                |            |            |
| For the nine months ended September 30,               |            |            |
| Total operating revenue.....                          | \$ 201,471 | \$ 180,050 |
| Costs of operations and other operating expenses..... | (68,603)   | (60,618)   |
| Other income and expense, net.....                    | 1,013      | 3,799      |
| Depreciation and amortization.....                    | (71,841)   | (63,720)   |
| Discontinued operations.....                          | -          | 1,643      |
| Minority interest.....                                | (9,888)    | (13,450)   |
|   | -----      | -----      |
| Net income.....                                       | \$ 52,152  | \$ 47,704  |
|   | =====      | =====      |

|   | At September 30,<br>2007 | At December 31,<br>2006 |
|---|--------------------------|-------------------------|
| -----   |                          |                         |
| (Amounts in thousands)                                |                          |                         |
| Total assets (primarily real estate).....             | \$ 1,549,951             | \$ 1,462,864            |
| Total debt.....                                       | 61,064                   | 67,048                  |
| Preferred equity and preferred minority interests.... | 811,000                  | 705,250                 |
| Common equity and common minority interests.....      | 631,199                  | 648,172                 |

### Other Investments -----

Other investments include an aggregate common equity ownership of approximately 29% in a) 12 entities that own an aggregate of 33 self-storage facilities that we held on a consistent basis for each of the three and nine months ended September 30, 2007 and 2006, respectively, and b) entities owning 11 self-storage facilities which we deconsolidated effective May 24, 2007 as described in Note 2.

The following table sets forth certain condensed financial information (representing 100% of these entities' balances and not our pro-rata share) with respect to these other investments:



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|  | 2007                   | 2006            |
|--|------------------------|-----------------|
|  | -----                  | -----           |
|  | (Amounts in thousands) |                 |
| For the nine months ended September 30,          |                        |                 |
| Total revenue.....                               | \$ 17,493              | \$ 17,209       |
| Cost of operations and other expenses            | (7,908)                | (6,929)         |
| Depreciation and amortization.....               | (2,210)                | (2,272)         |
|  | -----                  | -----           |
| Net income.....                                  | \$ 7,375               | \$ 8,008        |
|  | =====                  | =====           |
|  | At September 30,       | At December 31, |
|  | 2007                   | 2006            |
|  | -----                  | -----           |
|  | (Amounts in thousands) |                 |
| Total assets (primarily storage facilities)..... | \$ 73,042              | \$ 73,031       |
| Total liabilities.....                           | 21,205                 | 21,112          |
| Total Partners' equity.....                      | 51,837                 | 51,919          |

### 6. Revolving Line of Credit

On December 27, 2006, we entered into a \$300 million unsecured short-term credit agreement (the "Bridge Loan") with a commercial bank that matured April 1, 2007. Pursuant to the credit agreement, we borrowed \$300 million at an initial interest rate of LIBOR plus 0.30% (5.63% at December 31, 2006). At December 31, 2006, our outstanding borrowings under this facility totaled \$300 million. On January 10, 2007, borrowings under this facility were repaid in full and the Bridge Loan terminated.

On March 27, 2007, we entered into a five-year revolving credit agreement (the "Credit Agreement") with an aggregate limit with respect to borrowings and letters of credit of \$300 million, and bears an annual interest rate ranging from the London Interbank Offered Rate ("LIBOR") plus 0.35% to LIBOR plus 1.00% depending on our credit ratings (LIBOR plus 0.35% at September 30, 2007). In addition, we are required to pay a quarterly facility fee ranging from 0.10% per annum to 0.25% per annum depending on our credit ratings (0.10% per annum at September 30, 2007). We had no outstanding borrowings on our revolving line of credit at September 30, 2007 or at November 8, 2007.

The Credit Agreement includes various covenants, the more significant of which require us to (i) maintain a leverage ratio (as defined therein) of less than 0.55 to 1.00, (ii) maintain certain fixed charge and interest coverage ratios (as defined therein) of not less than 1.5 to 1.0 and 1.75 to 1.0, respectively, and (iii) maintain a minimum total shareholders' equity (as defined therein). We were in compliance with all covenants of the Credit Agreement at September 30, 2007.

At September 30, 2007, we had undrawn standby letters of credit, which reduce our borrowing capability with respect to our line of credit by the amount of the letters of credit, totaling \$20,408,000 (\$21,068,000 at December 31, 2006). The beneficiaries of these standby letters of credit were primarily certain insurance companies associated with our captive

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insurance and tenant re-insurance activities.

### 7. Notes Payable

The carrying amounts of our notes payable at September 30, 2007 and December 31, 2006 consist of the following (dollar amounts in thousands):

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|  | September 30,<br>2007 |
|--|-----------------------|
|  | -----                 |
| Domestic Unsecured Notes Payable:  |                       |
| 5.875% effective and stated note rate, interest only and payable<br>semi-annually, matures in March 2013.....  | \$ 200,000            |
| 5.73% effective rate, 7.75% stated note rate, interest only and payable<br>semi-annually, matures in February 2011 (carrying amount includes<br>\$11,877 of unamortized premium at September 30, 2007) .....   | 211,877               |
| 6.53% effective rate, 7.625% stated note rate, interest only and payable<br>semi-annually, due April 2007.....   | -                     |
| 7.66% senior unsecured note due January 2007.....  | -                     |
| Domestic Mortgage Notes:   |                       |
| 5.59% average effective rate fixed rate mortgage notes payable, secured by<br>53 real estate facilities with a net book value of \$410,853 at<br>September 30, 2007 and stated note rates between 4.95% and 7.76%, due<br>between October 2007 and August 2015 (carrying amount includes \$3,392<br>of unamortized premium at September 30, 2007) .....  | 145,021               |
| Variable rate mortgage notes payable.....  | -                     |
| 5.29% average effective rate fixed rate mortgage notes payable, secured by<br>33 real estate facilities with a net book value of \$187,678 at<br>September 30, 2007, stated note rates between 5.40% and 8.75%,<br>principal and interest payable monthly, due at varying dates between<br>October 2009 and September 2028 (carrying amount includes \$3,771 of<br>unamortized premium at September 30, 2007)..... | 87,834                |
| European Secured Notes Payable:  |                       |
| (euro)325 million notes payable due originally in 2011, but prepaid in<br>January 2007.....  | -                     |
| First Shurgard credit agreement, due in 2008, secured by 38 real estate<br>facilities with a net book value of \$282,300 at September 30, 2007<br>(interest rate of EURIBOR + 2.25%, 6.187% average for the nine months<br>ended September 30, 2007, 6.659% rate at September 30, 2007 which<br>approximate market rates).....   | 185,111               |
| Second Shurgard credit agreement, due in 2009, secured by 26 real estate<br>facilities with a net book value of \$199,200 at September 30, 2007  |                       |

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|  |              |
|--|--------------|
| (interest rate of EURIBOR + 2.25%, 6.187% average for the nine months ended September 30, 2007, 6.659% rate at September 30, 2007 which approximate market rates)..... | 167,570      |
| Liability under Capital Leases.....  | 7,094        |
|  | -----        |
| Total notes payable.....   | \$ 1,004,507 |
|  | =====        |

The 5.875% and 5.73% effective rate domestic unsecured notes payable were recorded at their estimated fair value upon assumption based upon estimated market rates for debt with similar terms and ratings. As of September 30, 2007 the aggregate fair value of these notes was approximately \$415,344,000 as compared to the actual assumed balances of \$400,000,000. This initial premium of \$15,344,000 is being amortized over the remaining term of the notes using the effective interest method.

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The domestic unsecured notes payable have various restrictive covenants, the more significant of which require us to (i) maintain a ratio of debt to total assets (as defined therein) of less than 0.60 to 1.00, (ii) maintain a ratio of secured debt to total assets (as defined therein) of less than 0.40 to 1.00, (iii) maintain a debt service coverage ratio (as defined therein) of greater than 1.50 to 1.00, and (iv) maintain a ratio of unencumbered assets to unsecured debt (as defined therein) of greater than 150%, all of which have been met at September 30, 2007.

The 5.59% average effective rate fixed rate domestic mortgage notes were recorded at their estimated fair value based upon the estimated market rate upon assumption of approximately 5.59%, an aggregate of approximately \$184,592,000 as compared to the actual assumed balances of an aggregate of \$179,827,000. This initial premium of \$4,765,000 is being amortized over the remaining term of the mortgage notes using the effective interest method. These mortgage notes require interest and principal payments to be paid monthly and have various restrictive covenants, all of which we believe have been met at September 30, 2007.

On January 2, 2007, we repaid the (euro)325 million collateralized European notes that were otherwise payable in 2011. We also terminated the related European currency and interest rate hedges.

First Shurgard and Second Shurgard, joint venture partnerships in which we have a 20% interest, (see Note 10) have senior credit agreements denominated in euros to borrow, in aggregate, up to (euro)271 million (\$386.5 million as of September 30, 2007). As of September 30, 2007, the available amounts under those credit facilities were, in the aggregate, (euro)22.5 million (\$32.1 million). Our draws under the First Shurgard and Second Shurgard credit facilities can be limited if the completion of projects is not timely and if we have certain cost overruns. The credit facilities also require us to maintain a maximum loan to value of the collateral ratio and a minimum debt service ratio. As of September 30, 2007, we were in compliance with these financial covenants.

At September 30, 2007, approximate principal maturities of our

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notes payable are as follows (amounts in thousands):

|                                 | Domestic<br>Unsecured<br>Notes Payable | Domestic<br>Mortgage Notes<br>Payable | European<br>Notes Payable | Liabilities<br>under<br>Capital Lease |
|---------------------------------|--|---------------------------------------|---------------------------|---------------------------------------|
| 2007 (remainder of).....        | \$ 808                                 | \$ 2,097                              | \$ 856                    | \$ 18                                 |
| 2008.....                       | 3,404                                  | 20,505                                | 184,256                   | 112                                   |
| 2009.....                       | 3,605                                  | 8,707                                 | 167,569                   | 123                                   |
| 2010.....                       | 3,817                                  | 10,584                                | -                         | 85                                    |
| 2011.....                       | 200,243                                | 27,355                                | -                         | 782                                   |
| Thereafter.....                 | 200,000                                | 163,607                               | -                         | 5,974                                 |
|                                 | \$ 411,877                             | \$ 232,855                            | \$ 352,681                | \$ 7,094                              |
| Weighted average effective rate | 5.8%                                   | 5.5%                                  | 6.2%                      | 9.9%                                  |

We incurred interest expense with respect to our notes payable, capital leases, debt to joint venture partner and line of credit aggregating \$51,783,000 and \$14,351,000 for the nine months ended September 30, 2007 and 2006, respectively. These amounts were comprised of \$55,375,000 and \$15,189,000 in cash for the nine months ended September 30, 2007 and 2006, respectively, less \$3,592,000 and \$838,000 in amortization of premium net of increase in debt to Joint Venture Partner described in Note 8, respectively.

The net book value of the properties under capital leases was \$33,451,000 as of September 30, 2007, which is net of accumulated depreciation of \$1,241,000.

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8. Debt to Joint Venture Partner

On December 31, 2004, we sold seven self-storage facilities to an unconsolidated affiliated joint venture for \$22,993,000. On January 14, 2005, we sold an 86.7% interest in three additional self-storage facilities to the joint venture for an aggregate amount of \$27,424,000. Our partner's combined equity contribution with respect to these transactions was \$35,292,000. Due to our continuing interest in these facilities and the likelihood that we will exercise our option to acquire our partner's interest, we have accounted for our partner's investment in these facilities as, in substance, debt financing. Accordingly, our partner's investment with respect to these facilities is accounted for as a liability on our accompanying consolidated balance sheets. Our partner's share of operations with respect to these facilities has been accounted for as interest expense on our accompanying consolidated statements of income.

The outstanding balances of \$37,395,000 and \$37,258,000 due the

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joint venture partner as of September 30, 2007 and December 31, 2006, respectively, approximate the fair value of our partner's interest in these facilities as of each respective date. On a quarterly basis, we review the fair value of this liability, and to the extent fair value exceeds the carrying value of the liability, an adjustment is made to increase the liability to fair value, and to increase other assets, with the other assets amortized over the remaining period term of the joint venture. We increased the note balance by \$1,386,000 during 2006 as a result of our periodic review of fair value.

A total of \$2,375,000 and \$2,276,000 was recorded as interest expense on our condensed consolidated statements of income with respect to our Debt to Joint Venture Partner during the nine months ended September 30, 2007 and 2006, respectively, representing our partner's pro rata share of net earnings with respect to the properties we sold to the Acquisition Joint Venture (an 8.5% return on their investment). This interest expense was comprised of a total of \$2,239,000 and \$2,146,000 paid to our joint venture partner (an 8.0% return payable currently in accordance with the partnership agreement) during the nine months ended September 30, 2007 and 2006, respectively, and increases in the Debt to Joint Venture Partner of \$136,000 and \$130,000 for the nine months ended September 30, 2007 and 2006, respectively.

We expect that this debt will be repaid during 2008, assuming that we exercise our option to acquire our partner's interest in the Acquisition Joint Venture.

### 9. Derivative Financial Instruments

As described in Note 2, under Derivative Financial Instruments, we report these derivative financial instruments at fair value on our consolidated balance sheet and changes in fair values for the nine months ended September 30, 2007, have been recognized in earnings. The respective balances of these financial instruments are included in other assets and accrued and other liabilities as follows:

|  | September 30,<br>2007  | December 31,<br>2006 |
|--|------------------------|----------------------|
|  | -----                  | -----                |
|  | (Amounts in thousands) |                      |
| <b>Assets:</b>                           |                        |                      |
| Interest rate contracts.....             | \$ 5,660               | \$ 11,810            |
|  | =====                  | =====                |
| <b>Liabilities:</b>                      |                        |                      |
| Interest rate contracts.....             | \$ -                   | \$ (4,162)           |
| Foreign currency exchange contracts..... | (1,146)                | (7,837)              |
|  | -----                  | -----                |
|  | \$ (1,146)             | \$ (11,999)          |
|  | =====                  | =====                |

For the nine months ended September 30, 2007, net income from derivatives of \$1,126,000 was comprised of a change in value of the related instruments representing gain of \$1,205,000, offset by \$79,000 in net payments incurred during the period under the underlying instruments.

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On January 2, 2007, in connection with our prepayment of the (euro)325 million collateralized notes at our European operations, we terminated the related European currency and interest rate hedges.

### 10. Minority Interest

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In consolidation, we classify ownership interests in the net assets of each of the Consolidated Entities, other than our own, as minority interest on the condensed consolidated financial statements. Minority interest in income consists of the minority interests' share of the operating results of the Consolidated Entities.

#### Preferred Partnership Interests

The following table summarizes the preferred partnership units outstanding at September 30, 2007 and December 31, 2006:

| Series                 | Earliest Redemption<br>Date or Dates<br>Redeemed | Distribution<br>Rate | September 30, 2007<br>Units<br>Outstanding | Carrying<br>Amount | December 31, 2006<br>Units<br>Outstanding |
|------------------------|--|----------------------|--|--------------------|---|
| -----                  | -----  | -----                | -----                                      | -----              | -----                                     |
| (Amounts in thousands) |  |                      |  |                    |   |
| Series NN.....         | March 17, 2010                                   | 6.400%               | 8,000                                      | \$ 200,000         | 8,000                                     |
| Series Z.....          | October 12, 2009                                 | 6.250%               | 1,000                                      | 25,000             | 1,000                                     |
| Series J.....          | May 9, 2011                                      | 7.250%               | 4,000                                      | 100,000            | 4,000                                     |
| Total.....             |  |                      | 13,000                                     | \$ 325,000         | 13,000                                    |
|                        |  |                      | 13,000                                     | \$ 325,000         | 13,000                                    |

Income allocated to the preferred minority interests totaled \$16,209,000 and \$13,652,000 for the nine months ended September 30, 2007 and 2006, respectively, comprised of distributions paid.

On May 9, 2006, one of the Consolidated Entities issued 4,000,000 units of our 7.25% Series J Preferred Partnership Units for cash proceeds of \$100,000,000.

Subject to certain conditions, the Series NN preferred units are convertible into our 6.40% Series NN Cumulative Preferred Shares of beneficial interest, the Series Z preferred units are convertible into our 6.25% Series Z Cumulative Preferred Shares of beneficial interest and the Series J preferred units are convertible into our 7.25% Series J Cumulative Preferred Shares of beneficial interest. The holders of the Series Z preferred partnership units have a one-time option exercisable five years from issuance (October 12, 2009), to require us to redeem their units for \$25,000,000 in cash, plus any unpaid distribution.

#### Other Partnership Interests

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Income is allocated to the minority interests based upon their pro rata interest in the operating results of the Consolidated Entities. The following tables set forth the minority interests at September 30, 2007 and December 31, 2006 as well as the income allocated to minority interests

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for the three and nine months ended September 30, 2007 and 2006 with respect to the other partnership interests (amounts in thousands):

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| Description                        | Minority Interest at  |                      |
|------------------------------------|-----------------------|----------------------|
|                                    | September 30,<br>2007 | December 31,<br>2006 |
| European joint ventures.....       | \$ 140,893            | \$ 140,034           |
| European investors.....            | 3,607                 | -                    |
| Convertible Partnership Units..... | 5,494                 | 5,710                |
| Other consolidated partnerships... | 31,778                | 35,286               |
| Total other partnership interests. | \$ 181,772            | \$ 181,030           |
|                                    | =====                 | =====                |

| Description                        | Minority Interests<br>in Income (Loss)<br>for the Three Months Ended |                       | Minority Interests<br>in Income (Loss)<br>for the Nine Months Ended |                   |
|------------------------------------|--|-----------------------|---|-------------------|
|                                    | September 30,<br>2007  | September 30,<br>2006 | September 30,<br>2007   | September<br>2006 |
| European joint ventures.....       | \$ (1,456)   | \$ (1,279)            | \$ (7,275)  | \$ (1,            |
| European investors.....            | (109)  | -                     | (109)   |                   |
| Convertible Partnership Units..... | 121  | 120                   | 132   |                   |
| Other consolidated partnerships..  | 4,345  | 4,346                 | 12,654  | 11,               |
| Total other partnership interests  | \$ 2,901   | \$ 3,187              | \$ 5,402  | \$ 10,            |
|                                    | =====  | =====                 | =====   | =====             |

Distributions paid to minority interests for the three months ended September 30, 2007 and 2006 were \$5,471,000 and \$3,689,000, respectively, and for the nine months ended September 30, 2007 and 2006 were \$15,828,000 and \$11,037,000, respectively. Minority interests increased \$8,134,000 as a result of the impact of foreign currency translation in the nine months ended September 30, 2007.

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European Joint Ventures  
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Through the merger with Shurgard, we acquired an interest in two joint venture entities: First Shurgard SPRI ("First Shurgard") formed in January 2003 and Second Shurgard SPRL ("Second Shurgard") formed in May 2004. Those joint ventures were expected to develop or acquire up to approximately 75 storage facilities in Europe. Through a wholly-owned subsidiary, we have a 20% interest in each of these ventures. We have determined that First Shurgard and Second Shurgard are each VIEs, and that we are the primary beneficiary. Accordingly, First Shurgard and Second Shurgard have been consolidated in our consolidated financial statements. At September 30, 2007, First Shurgard and Second Shurgard had aggregate total assets of \$559.4 million (\$501.0 million at December 31, 2006), total liabilities of \$380.4 million (\$320.9 million at December 31, 2006), and credit facilities collateralized by assets with a net book value of \$481.5 million. At September 30, 2007, First Shurgard's and Second Shurgard's creditors had no recourse to the general credit of Public Storage or Shurgard Europe other than a commitment, to subscribe for up to \$20 million and an additional \$10.7 million as of September 30, 2007 in preferred bonds in order for First Shurgard to fulfill its obligations under its senior credit agreement. We have an option to put 80% of the bonds issued by First Shurgard to Crescent Euro Self Storage Investments, Shurgard Europe's partner in the joint venture.

On September 5, 2006, we informed the joint venture partners of First Shurgard and Second Shurgard of our intention to purchase their interests in First Shurgard and Second Shurgard, pursuant to an "exit procedure" that we believe is provided for in the respective agreements. The exit procedure can, in certain circumstances, result in a third party acquiring the facilities owned by First and Second Shurgard, including our interest in these facilities. Our joint venture partners currently contest whether we have the right to purchase their interests under this procedure. On January 17, 2007, we filed an arbitration action with our joint venture partner related to our intention to terminate the joint venture early. See Note 15 for further discussion of the arbitration proceedings.

### European Investors

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In the second quarter of 2007, one of our European subsidiaries sold limited liability partner interests ("LLP Interests") it held in Shurgard Self-Storage SCA ("Shurgard Europe"), also an indirect subsidiary of Public Storage, to various officers of the Company, other than our chief executive officer. The aggregate proceeds of the sale were \$4,909,000. The sale price for the LLP Interests was the net asset value per LLP Interest using, among other items, information provided by an independent third party appraisal firm of the net asset value of Shurgard Europe as of March 31, 2007. The Company has a right to repurchase the LLP Interests upon (1) upon a purchaser's termination of employment or (2) for any reason, on or after May 14, 2008. The repurchase price is set at the lesser of (1) the then net asset value per share or (2) the original purchase price with a 10% compounded annual return. In connection with the sale of these LLP Interests, we recorded a gain of \$1,193,000 for the nine months ended September 30, 2007, representing the excess of the sales proceeds over the book value of the LLP Interests sold. The gain is reflected in gain on disposition of real estate investments on our accompanying condensed consolidated statements of income. The investment of these various officers is included in minority interest - other partnership interests on our accompanying condensed consolidated balance sheet at September 30, 2007 and their pro rata share of the earnings of Shurgard Europe are reflected in minority interest in income - other partnership interests on our accompanying condensed consolidated statements of income for the three and nine months ended September 30, 2007.



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### Convertible Partnership Units

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At September 30, 2007 and December 31, 2006, one of the Consolidated Entities had approximately 231,978 convertible partnership units ("Convertible Units") outstanding representing a limited partnership interest in the partnership. The Convertible Units are convertible on a one-for-one basis (subject to certain limitations) into common shares of the Company at the option of the unit-holder. Minority interest in income with respect to Convertible Units reflects the Convertible Units' share of our net income, with net income allocated to minority interests with respect to weighted average outstanding Convertible Units on a per unit basis equal to diluted earnings per common share.

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### Other Consolidated Partnerships

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The partnership agreements of the Other Consolidated Partnerships included in the table above have termination dates that cannot be unilaterally extended by the Company and, upon termination of each partnership, the net assets of these entities would be liquidated and paid to the minority interests and the Company based upon their relative ownership interests.

In connection with the merger with Shurgard, we obtained partial equity interests in certain joint ventures. Following the merger with Shurgard, in 2006 we acquired the minority interests in certain of these joint ventures, for an aggregate of approximately \$62,300,000 in cash. As a result of these transactions, we obtained the remaining interest in a total of 68 self-storage facilities. This acquisition was recorded as a reduction in minority interest totaling \$12,177,000, with the remainder allocated to real estate (\$50,123,000).

In May 2007 we discontinued the consolidation of certain of these joint ventures due to our losing control of these entities. As a result, minority interest in income with respect to these joint ventures ceased effective May 2007, and \$682,000 in minority interest was eliminated. See Note 2 for further information.

The partnership agreements of the Shurgard Domestic Joint Ventures have termination dates that cannot be unilaterally extended by the Company and, upon termination of each partnership, the net assets of these entities would be liquidated and paid to the minority interests and the Company based upon their relative ownership interests.

At September 30, 2007 and December 31, 2006, the Other Consolidated Partnerships reflect common equity interests that we do not own in 33 entities owning an aggregate of 117 self-storage facilities.

### Impact of SFAS No. 150

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In May 2003, the FASB issued Statement of Financial Accounting

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Standards No. 150 - "Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity" ("SFAS No. 150"). This statement prescribes reporting standards for financial instruments that have characteristics of both liabilities and equity. This standard generally indicates that certain financial instruments that give the issuer a choice of setting an obligation with a variable number of securities or settling an obligation with a transfer of assets, any mandatorily redeemable security, and certain put options and forward purchase contracts, should be classified as a liability on the balance sheet. With the exception of minority interests, described below, we implemented SFAS No. 150 on July 1, 2003, and the adoption had no impact on our financial statements.

The provisions of SFAS No. 150 indicate that the Other Minority Interests would have to be treated as a liability, because these partnerships have termination dates that cannot be unilaterally extended by us and, upon termination, the net assets of these entities would be liquidated and paid to the minority interest and us based upon relative ownership interests. However, on October 29, 2003, the FASB decided to defer indefinitely a portion of the implementation of SFAS No. 150, which thereby deferred our requirement to recognize these minority interest liabilities. We estimate that the fair value of the Other Partnership Interests is approximately \$450 million at December 31, 2006 and September 30, 2007.

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11. Shareholders' Equity

Cumulative Preferred Shares

At September 30, 2007 and December 31, 2006, we had the following series of Cumulative Preferred Shares of beneficial interest outstanding:

| Series                       | Earliest<br>Redemption<br>Date | Dividend<br>Rate | At September 30, 2007 |                    | At Decem              |
|------------------------------|--------------------------------|------------------|-----------------------|--------------------|-----------------------|
|                              |                                |                  | Shares<br>Outstanding | Carrying<br>Amount | Shares<br>Outstanding |
| (Dollar amounts in thousand) |                                |                  |                       |                    |                       |
| Series V                     | 9/30/07                        | 7.500%           | 6,900                 | \$ 172,500         | 6,900                 |
| Series W                     | 10/6/08                        | 6.500%           | 5,300                 | 132,500            | 5,300                 |
| Series X                     | 11/13/08                       | 6.450%           | 4,800                 | 120,000            | 4,800                 |
| Series Y                     | 1/2/09                         | 6.850%           | 1,600,000             | 40,000             | 1,600,000             |
| Series Z                     | 3/5/09                         | 6.250%           | 4,500                 | 112,500            | 4,500                 |
| Series A                     | 3/31/09                        | 6.125%           | 4,600                 | 115,000            | 4,600                 |
| Series B                     | 6/30/09                        | 7.125%           | 4,350                 | 108,750            | 4,350                 |
| Series C                     | 9/13/09                        | 6.600%           | 4,600                 | 115,000            | 4,600                 |
| Series D                     | 2/28/10                        | 6.180%           | 5,400                 | 135,000            | 5,400                 |
| Series E                     | 4/27/10                        | 6.750%           | 5,650                 | 141,250            | 5,650                 |
| Series F                     | 8/23/10                        | 6.450%           | 10,000                | 250,000            | 10,000                |

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|                                   |          |        |           |              |         |
|-----------------------------------|----------|--------|-----------|--------------|---------|
| Series G                          | 12/12/10 | 7.000% | 4,000     | 100,000      | 4,0     |
| Series H                          | 1/19/11  | 6.950% | 4,200     | 105,000      | 4,2     |
| Series I                          | 5/3/11   | 7.250% | 20,700    | 517,500      | 20,7    |
| Series K                          | 8/8/11   | 7.250% | 18,400    | 460,000      | 18,4    |
| Series L                          | 10/20/11 | 6.750% | 9,200     | 230,000      | 9,2     |
| Series M                          | 1/9/12   | 6.625% | 20,000    | 500,000      |         |
| Series N                          | 7/2/12   | 7.000% | 6,900     | 172,500      |         |
| Total Cumulative Preferred Shares |          |        | 1,739,500 | \$ 3,527,500 | 1,712,6 |

The holders of our Cumulative Preferred Shares have general preference rights with respect to liquidation and quarterly distributions. Holders of the preferred shares, except under certain conditions and as noted below, will not be entitled to vote on most matters. In the event of a cumulative arrearage equal to six quarterly dividends or failure to maintain a Debt Ratio (as defined) of 50% or less, holders of all outstanding series of preferred shares (voting as a single class without regard to series) will have the right to elect two additional members to serve on the Company's Board until events of default have been cured. At September 30, 2007, there were no dividends in arrears and the Debt Ratio was 8.2%.

Upon issuance of our Cumulative Preferred Shares of beneficial interest, we classify the liquidation value as preferred equity on our condensed consolidated balance sheet with any issuance costs recorded as a reduction to paid-in capital. Upon redemption, we apply EITF Topic D-42, allocating income to the preferred shareholders equal to the original issuance costs.

On January 9, 2007, we issued 20,000 depositary shares, with each depositary share representing 1/1,000 of a share of our 6.625% Cumulative Preferred Shares, Series M. The offering resulted in \$500,000,000 of gross proceeds.

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On July 2, 2007, we issued 6,900,000 depositary shares each representing 1/1,000 of our 7.000% Cumulative Preferred Shares, Series N, for gross proceeds of approximately \$172,500,000.

During 2006, we issued four series of Cumulative Preferred Shares: Series H - issued January 19, 2006, net proceeds totaling \$101,492,000, Series I - issued May 3, 2006, net proceeds totaling \$501,601,000, Series K - issued August 8, 2006, net proceeds totaling \$445,852,000 and Series L - issued October 20, 2006, net proceeds totaling \$223,623,000.

During 2006, we redeemed our Series R and Series S Cumulative Preferred Shares at par value plus accrued dividends. In December 2006, we called for redemption our Series T and Series U Cumulative Preferred Shares, at par. The aggregated redemption value of \$302,150,000 of these two series was classified as a liability at December 31, 2006 and repaid in the nine months ended September 30, 2007.

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### Equity Shares -----

The Company is authorized to issue 100,000,000 Equity Shares of beneficial interest. The Articles of Amendment and Restatement of Declaration of Trust provide that the Equity Shares may be issued from time to time in one or more series and give our Board broad authority to fix the dividend and distribution rights, conversion and voting rights, redemption provisions and liquidation rights of each series of Equity Shares.

### Equity Shares, Series A -----

At September 30, 2007 and December 31, 2006, we had 8,744,193 depositary shares outstanding, each representing 1/1,000 of an Equity Share, Series A ("Equity Shares A"). The Equity Shares A rank on parity with our common shares and junior to the Cumulative Preferred Shares with respect to general preference rights and have a liquidation amount which cannot exceed \$24.50 per share. Distributions with respect to each depositary share shall be the lesser of: (i) five times the per share dividend on our common shares or (ii) \$2.45 per annum. We have no obligation to pay distributions on the depositary shares if no distributions are paid to common shareholders.

Except in order to preserve the Company's Federal income tax status as a REIT, we may not redeem the depositary shares representing the Equity Shares A before March 31, 2010. On or after March 31, 2010, we may, at our option, redeem the depositary shares at \$24.50 per depositary share. If the Company fails to preserve its Federal income tax status as a REIT, each of the depositary shares will be convertible at the option of the shareholder into .956 common shares. The depositary shares are otherwise not convertible into common shares. Holders of depositary shares vote as a single class with holders of our common shares on shareholder matters, but the depositary shares have the equivalent of one-tenth of a vote per depositary share.

### Equity Shares, Series AAA -----

In November 1999, we sold \$100,000,000 (4,289,544 shares) of Equity Shares, Series AAA ("Equity Shares AAA") to the Consolidated Development Joint Venture. On November 17, 2005, upon the acquisition of Mr. Hughes' interest in PSAC, we owned 100% of the partnership interest in the Consolidated Development Joint Venture. For all periods presented, the Equity Shares, Series AAA and related dividends are eliminated in consolidation.

### Common Shares -----

During the nine months ended September 30, 2007, we issued 258,413 common shares in connection with employee stock-based compensation.

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At September 30, 2007 and December 31, 2006, certain entities we

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consolidate owned 1,146,207 common shares. These shares continue to be legally issued and outstanding. In the consolidation process, these shares and the related balance sheet amounts have been eliminated. In addition, these shares are not included in the computation of weighted average shares outstanding.

### Dividends

-----

The following table summarizes dividends declared and paid during the nine months ended September 30, 2007:

|                              | Distributions Per Share<br>or Depositary Share | Total<br>Distributions |
|------------------------------|--|------------------------|
|                              | -----  | -----                  |
| Preferred Shares:            |  |                        |
| Series T.....                | \$0.090  | \$ 548,000             |
| Series U.....                | \$0.259  | 1,557,000              |
| Series V.....                | \$1.406  | 9,703,000              |
| Series W.....                | \$1.219  | 6,459,000              |
| Series X.....                | \$1.209  | 5,805,000              |
| Series Y.....                | \$1.284  | 2,055,000              |
| Series Z.....                | \$1.172  | 5,274,000              |
| Series A.....                | \$1.148  | 5,283,000              |
| Series B.....                | \$1.336  | 5,811,000              |
| Series C.....                | \$1.238  | 5,694,000              |
| Series D.....                | \$1.159  | 6,258,000              |
| Series E.....                | \$1.266  | 7,152,000              |
| Series F.....                | \$1.209  | 12,093,000             |
| Series G.....                | \$1.313  | 5,250,000              |
| Series H.....                | \$1.303  | 5,473,000              |
| Series I.....                | \$1.359  | 28,139,000             |
| Series K.....                | \$1.359  | 25,012,000             |
| Series L.....                | \$1.266  | 11,644,000             |
| Series M.....                | \$1.210  | 24,200,000             |
| Series N.....                | \$0.437  | 3,014,000              |
|                              |  | -----                  |
|                              |  | 176,424,000            |
| Common Shares:               |  |                        |
| Equity Shares, Series A..... | \$1.838  | 16,068,000             |
| Common .....                 | \$1.500  | 255,022,000            |
|                              |  | -----                  |
| Total dividends.....         |  | \$ 447,514,000         |
|                              |  | =====                  |

The dividend rate on our common shares was \$0.50 per common share and \$1.50 per common share for the three and nine months ended September 30, 2007. The dividend rate on the Equity Share A was \$0.6125 per depositary share and \$1.8375 per depositary share for the three and nine months ended September 30, 2007, respectively.

### 12. Segment Information

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#### Description of Each Reportable Segment

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Our reportable segments reflect significant operating activities that are evaluated separately by management, comprised of the following segments which are organized based upon their operating characteristics.

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Our domestic self-storage segment comprises the direct ownership, development, and operation of traditional storage facilities in the U.S., and the ownership of equity interests in entities that own storage properties in the U.S. Our European self-storage segment comprises our self-storage and associated activities owned by affiliated entities based in Europe.

Our domestic ancillary operating segment represents all of our other segments, which are reported as a group, including with respect to our domestic operations (i) containerized storage, (ii) commercial property operations, which reflects our interest in the ownership, operation, and management of commercial properties both directly and through our interest in PSB (iii) the reinsurance of policies against losses to goods stored by tenants in our self-storage facilities, (iv) sale of merchandise at our self-storage facilities, (v) truck rentals at our self-storage facilities and (vi) management of facilities owned by third-party owners and facilities owned by the Unconsolidated Entities.

Measurement of Segment Income (Loss) and Segment Assets -  
-----  
Domestic Self-Storage and Domestic Ancillary  
-----

The domestic self-storage and domestic ancillary segments are evaluated by management based upon the net segment income of each segment. Net segment income represents net income in conformity with GAAP and our significant accounting policies as denoted in Note 2, before interest and other income, interest expense, and corporate general and administrative expense. Interest and other income, interest expense, corporate general and administrative expense, minority interest in income and gains and losses on sales of real estate assets are not allocated to these segments because management does not utilize them to evaluate the results of operations of each segment. In addition, there is no presentation of segment assets for these other segments because total assets are not considered in the evaluation of these segments.

Measurement of Segment Income (Loss) and Segment Assets -  
-----  
European Operations  
-----

The European segment operations are primarily independent of the other segments, with separate management, debt, financing activities, and capital allocation decisions. The operations of our European segment are included in our financial statements effective August 23, 2006 when we completed the merger with Shurgard. Accordingly, this segment is evaluated by management as a stand-alone business unit and the European segment presentation includes all of the revenues, expenses, and operations of this business unit, including interest expense paid to outside parties and general and administrative expense. Assets of our European operations at September 30, 2007, include real estate with a book value of approximately \$1.6 billion (\$1.4 billion at December 31, 2006), intangibles with a book value of approximately \$110 million (\$167 million at December 31, 2006), and other assets with a book value of approximately \$61 million (\$65

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million at December 31, 2006). At September 30, 2007, liabilities of our European operations include; intercompany payables of \$556 million (\$542 million at December 31, 2006), debt of \$360 million (\$724 million at December 31, 2006) and accrued and other liabilities of \$92 million (\$108 million at December 31, 2006). At December 31, 2006, assets of our European operations included approximately \$480 million in cash (of which approximately \$429 million was utilized on January 2, 2007 to prepay the (euro)325M collateralized notes).

### Presentation of Segment Information

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The following table reconciles the performance of each segment, in terms of segment income, to our consolidated net income (amounts in thousands):

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For the three months ended September 30, 2007

|   | Domestic<br>Self-Storage | European<br>Operations | Domestic<br>Ancillary<br>Operations |
|---|--------------------------|------------------------|-------------------------------------|
|   | -----                    | -----                  | -----                               |
|   | (Amounts in thousands)   |                        |                                     |
| <b>Revenues:</b>  |                          |                        |                                     |
| Self-storage rental income.....   | \$ 377,877               | \$ 50,072              | \$ -                                |
| Ancillary operating revenue.....  | -                        | 4,775                  | 32,979                              |
| Interest and other income.....  | -                        | -                      | -                                   |
|   | -----                    | -----                  | -----                               |
|   | 377,877                  | 54,847                 | 32,979                              |
|   | -----                    | -----                  | -----                               |
| <b>Expenses:</b>  |                          |                        |                                     |
| Cost of operations (excluding depreciation and<br>amortization below):  |                          |                        |                                     |
| Self-storage facilities.....  | 121,949                  | 21,422                 | -                                   |
| Ancillary operations.....   | -                        | 1,427                  | 21,260                              |
| Depreciation and amortization.....  | 114,965                  | 31,899                 | 903                                 |
| General and administrative.....   | -                        | 2,193                  | -                                   |
| Interest expense.....   | -                        | 5,917                  | -                                   |
|   | -----                    | -----                  | -----                               |
|   | 236,914                  | 62,858                 | 22,163                              |
|   | -----                    | -----                  | -----                               |
| Income (loss) from continuing operations before<br>equity in earnings of real estate entities,<br>gain on disposition of real estate<br>investments, foreign currency exchange gain,<br>income from derivatives and minority interest<br>in income..... | 140,963                  | (8,011)                | 10,816                              |
| Equity in earnings of real estate entities.....   | 902                      | -                      | -                                   |
| Gain on disposition of real estate investments...   | -                        | -                      | -                                   |

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|   |            |           |           |
|---|------------|-----------|-----------|
| Foreign currency exchange gain.....           | -          | 30,384    | -         |
| Income from derivatives, net.....             | -          | 117       | -         |
| Minority interest in (income) loss.....       | (4,466)    | 1,565     | -         |
|   | -----      | -----     | -----     |
| Income (loss) from continuing operations..... | 137,399    | 24,055    | 10,816    |
| Discontinued operations.....                  | -          | (151)     | -         |
|   | -----      | -----     | -----     |
| Net income (loss).....                        | \$ 137,399 | \$ 23,904 | \$ 10,816 |
|   | =====      | =====     | =====     |

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For the three months ended September 30, 2006

|   | Domestic<br>Self-Storage | European<br>Operations | Domestic<br>Ancillary<br>Operations |
|---|--------------------------|------------------------|-------------------------------------|
|   | -----                    | -----                  | -----                               |
|   | (Amounts in thousands)   |                        |                                     |
| <b>Revenues:</b>  |                          |                        |                                     |
| Self-storage rental income.....   | \$ 311,434               | \$ 17,348              | \$ -                                |
| Ancillary operating revenue.....  | -                        | 1,562                  | 28,265                              |
| Interest and other income.....  | -                        | -                      | -                                   |
|   | -----                    | -----                  | -----                               |
|   | 311,434                  | 18,910                 | 28,265                              |
|   | -----                    | -----                  | -----                               |
| <b>Expenses:</b>  |                          |                        |                                     |
| Cost of operations (excluding depreciation and<br>amortization below):  |                          |                        |                                     |
| Self-storage facilities.....  | 100,582                  | 8,524                  | -                                   |
| Ancillary operations.....   | -                        | 636                    | 17,878                              |
| Depreciation and amortization.....  | 97,634                   | 15,020                 | 809                                 |
| General and administrative.....   | -                        | 4,642                  | -                                   |
| Interest expense.....   | -                        | 3,432                  | -                                   |
|   | -----                    | -----                  | -----                               |
|   | 198,216                  | 32,254                 | 18,687                              |
|   | -----                    | -----                  | -----                               |
| Income (loss) from continuing operations before<br>equity in earnings of real estate entities,<br>gain on disposition of real estate<br>investments, foreign currency exchange loss,<br>income from derivatives and minority interest<br>in income..... | 113,218                  | (13,344)               | 9,578                               |
| Equity in earnings of real estate entities.....   | 600                      | -                      | -                                   |
| Gain on disposition of real estate investments...   | -                        | -                      | -                                   |
| Foreign currency exchange loss.....   | -                        | (172)                  | -                                   |
| Income from derivatives, net.....   | -                        | 32                     | -                                   |
| Minority interest in income.....  | (4,466)                  | 1,279                  | -                                   |



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|   |            |             |          |
|---|------------|-------------|----------|
| Income (loss) from continuing operations..... | 109,352    | (12,205)    | 9,578    |
| Discontinued operations.....                  | -          | (21)        | -        |
| Net income (loss).....                        | \$ 109,352 | \$ (12,226) | \$ 9,578 |

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
September 30, 2007  
(Unaudited)

For the nine months ended September 30, 2007

|  | Domestic<br>Self-Storage | European<br>Operations | Domestic<br>Ancillary<br>Operations |
|--|--------------------------|------------------------|-------------------------------------|
| (Amounts in thousands)   |                          |                        |                                     |
| <b>Revenues:</b>   |                          |                        |                                     |
| Self-storage rental income.....  | \$ 1,097,655             | \$ 140,291             | \$ -                                |
| Ancillary operating revenue.....   | -                        | 12,878                 | 95,025                              |
| Interest and other income.....   | -                        | -                      | -                                   |
|  | 1,097,655                | 153,169                | 95,025                              |
| <b>Expenses:</b>   |                          |                        |                                     |
| Cost of operations (excluding depreciation and<br>amortization below):   |                          |                        |                                     |
| Self-storage facilities.....   | 374,075                  | 67,582                 | -                                   |
| Ancillary operations.....  | -                        | 4,125                  | 59,294                              |
| Depreciation and amortization.....   | 378,975                  | 110,101                | 2,649                               |
| General and administrative.....  | -                        | 16,922                 | -                                   |
| Interest expense.....  | -                        | 16,247                 | -                                   |
|  | 753,050                  | 214,977                | 61,943                              |
| Income (loss) from continuing operations before<br>equity in earnings of real estate entities,<br>casualty gain, gain on disposition of real<br>estate investments, foreign currency exchange<br>gain, income from derivatives and minority<br>interest in income..... | 344,605                  | (61,808)               | 33,082                              |
| Equity in earnings of real estate entities.....  | 1,947                    | -                      | -                                   |
| Casualty gain.....   | 2,665                    | -                      | -                                   |
| Gain on disposition of real estate investments...  | -                        | -                      | -                                   |
| Foreign currency exchange gain.....  | -                        | 40,977                 | -                                   |
| Income from derivatives, net.....  | -                        | 1,126                  | -                                   |
| Minority interest in (income) loss.....  | (12,677)                 | 7,275                  | -                                   |
| Income (loss) from continuing operations.....  | 336,540                  | (12,430)               | 33,082                              |
| Discontinued operations.....   | -                        | (281)                  | -                                   |

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|                        |            |             |           |
|------------------------|------------|-------------|-----------|
| Net income (loss)..... | \$ 336,540 | \$ (12,711) | \$ 33,082 |
|------------------------|------------|-------------|-----------|

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PUBLIC STORAGE  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
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(Unaudited)

For the nine months ended September 30, 2006

|  | Domestic<br>Self-Storage | European<br>Operations | Domestic<br>Ancillary<br>Operations |
|--|--------------------------|------------------------|-------------------------------------|
| (Amounts in thousands)   |                          |                        |                                     |
| Revenues:  |                          |                        |                                     |
| Self-storage rental income.....  | \$ 825,013               | \$ 17,348              | \$ -                                |
| Ancillary operating revenue.....   | -                        | 1,562                  | 75,938                              |
| Interest and other income.....   | -                        | -                      | -                                   |
|  | 825,013                  | 18,910                 | 75,938                              |
| Expenses:  |                          |                        |                                     |
| Cost of operations (excluding depreciation and<br>amortization below):   |                          |                        |                                     |
| Self-storage facilities.....   | 277,680                  | 8,524                  | -                                   |
| Ancillary operations.....  | -                        | 636                    | 49,679                              |
| Depreciation and amortization.....   | 194,625                  | 15,020                 | 2,412                               |
| General and administrative.....  | -                        | 4,642                  | -                                   |
| Interest expense.....  | -                        | 3,432                  | -                                   |
|  | 472,305                  | 32,254                 | 52,091                              |
| Income (loss) from continuing operations before<br>equity in earnings of real estate entities,<br>casualty gain, gain on disposition of real<br>estate investments, foreign currency exchange<br>loss, income from derivatives and minority<br>interest in income..... | 352,708                  | (13,344)               | 23,847                              |
| Equity in earnings of real estate entities.....  | 1,574                    | -                      | -                                   |
| Gain on disposition of real estate investments...  | -                        | -                      | -                                   |
| Foreign currency exchange loss.....  | -                        | (172)                  | -                                   |
| Income from derivatives, net.....  | -                        | 32                     | -                                   |
| Minority interest in income.....   | (12,104)                 | 1,279                  | -                                   |
| Income (loss) from continuing operations.....  | 342,178                  | (12,205)               | 23,847                              |
| Cumulative effect of a change in accounting<br>principle.....  | -                        | -                      | -                                   |
| Discontinued operations.....   | -                        | (21)                   | -                                   |
| Net income (loss).....   | \$ 342,178               | \$ (12,226)            | \$ 23,847                           |

13. Share-Based Compensation  
-----

Stock Options  
-----

We have various stock option plans (collectively referred to as the "PS Plans"). Under the PS Plans, the Company has granted non-qualified options to certain trustees, officers and key employees to purchase shares of the Company's common stock at a price equal to the fair market value of the common stock at the date of grant. Generally, options under the PS Plans vest over a three-year period from the date of grant at the rate of one-third per year (options granted after December 31, 2002 vest generally over a five-year period) and expire between eight years and ten years after the date they became exercisable. The PS Plans also provide for the grant of restricted stock (see below) to officers, key employees and service providers on terms determined by an authorized committee of our Board.

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We recognize compensation expense for share-based awards based upon their fair value on the date of grant amortized over the applicable vesting period (the "Fair Value Method"), less an allowance for estimated future forfeited awards.

For the three and nine months ended September 30, 2007 we recorded \$695,000 and \$1,301,000, respectively, in stock option compensation expense related to options granted after January 1, 2002, as compared to \$360,000 and \$958,000, for the same periods in 2006.

A total of 240,000 stock options were granted during the nine months ended September 30, 2007, 191,095 shares were exercised, and no shares were forfeited. A total of 1,651,839 stock options were outstanding at September 30, 2007 (1,602,934 at December 31, 2006).

Restricted Share Units  
-----

Outstanding restricted share units vest over a five or eight-year period from the date of grant at the rate of one-fifth or one-eighth per year, respectively. The employee receives additional compensation equal to the per-share dividends received by common shareholders with respect to restricted share units outstanding. Such compensation is accounted for as dividends paid. Any dividends paid on units which are subsequently forfeited are expensed. Upon vesting, the employee receives common shares equal to the number of vested restricted share units in exchange for the units.

The total value of each restricted share unit grant, based upon the market price of our common shares at the date of grant, is amortized over the vesting period as compensation expense. The related employer portion of payroll taxes is expensed as incurred. Until December 31, 2005 (see below), forfeitures were recognized as experienced, reducing

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compensation expense.

Effective January 1, 2006, in accordance with Statement of Financial Accounting Standards No. 123 - revised ("FAS 123R"), we began recording compensation expense net of estimates for future forfeitures (the "Estimated Forfeiture Method"). In addition, we estimated the cumulative compensation expense that would have been recorded through December 31, 2005, had we used the Estimated Forfeiture Method, would have been \$578,000 lower. Accordingly, as prescribed by FAS 123R, we recorded this adjustment as a cumulative effect of change in accounting principal on our accompanying condensed consolidated statement of income for the nine months ended September 30, 2006.

Outstanding restricted share units are included on a one-for-one basis in our diluted weighted average shares, less a reduction for the treasury stock method applied to the average cumulative measured but unrecognized compensation expense during the period. For purposes of the disclosures that follow, "fair value" on any particular date reflects the closing market price of our common shares on that date.

During the nine months ended September 30, 2007, 170,175 restricted share units were granted, 69,992 restricted share units were forfeited, and 100,477 restricted share units vested. This vesting resulted in the issuance of 67,318 shares of the Company's common shares. In addition, cash compensation was paid to employees in lieu of 30,485 common shares based upon the market value of the shares at the date of vesting, and used to settle the employees' tax liability generated by the vesting.

At September 30, 2007, approximately 616,176 restricted share units were outstanding (616,470 at December 31, 2006). A total of \$1,751,000 and \$6,013,000 in restricted share expense was recorded for the three and nine months ended September 30, 2007, respectively, as compared to \$1,200,000 and \$3,629,000, for the same periods in 2006.

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14. Related Party Transactions  
-----

Relationships and transactions with the Hughes Family  
-----

Mr. Hughes and his family (collectively the "Hughes Family") have ownership interests in, and operate approximately 48 self-storage facilities in Canada under the name "Public Storage" ("PS Canada") pursuant to a license agreement with the Company. We currently do not own any interests in these facilities nor do we own any facilities in Canada. The Hughes Family owns approximately 27% of our common shares outstanding at September 30, 2007. We have a right of first refusal to acquire the stock or assets of the corporation that manages the 48 self-storage facilities in Canada, if the Hughes Family or the corporation agrees to sell them. However, we have no interest in the operations of this corporation, we have no right to acquire this stock or assets unless the Hughes Family decides to sell, the right of first refusal does not apply to the self-storage facilities, and we receive no benefit from the profits and increases in value of the Canadian self-storage facilities.

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Through consolidated entities, we continue to reinsure risks relating to loss of goods stored by tenants in the self-storage facilities in Canada. During the nine months ended September 30, 2007 and 2006, respectively, we received \$666,000 and \$759,000, respectively, in reinsurance premiums attributable to the Canadian facilities. Since our right to provide tenant reinsurance to the Canadian facilities may be qualified, there is no assurance that these premiums will continue.

The Company and Mr. Hughes are co-general partners in certain consolidated entities and affiliated entities of the Company that are not consolidated, and the Hughes Family owns 47.9% of the voting stock of a private REIT in which the Company holds 46% of the voting and 100% of the nonvoting stock of the entity and substantially all the economic interest. The Hughes Family also owns limited partnership interests in certain of these partnerships and holds securities in PSB. The Company and the Hughes Family receive distributions from these entities in accordance with the terms of the partnership agreements or other organizational documents.

### Other Related Party Transactions

-----

Ronald L. Havner, Jr. is our Vice-Chairman and Chief Executive Officer, and he is Chairman of the Board of PSB.

Dann V. Angeloff, a trustee of the Company, is the general partner of a limited partnership formed in June of 1973 that owns a self-storage facility that is managed by us. We recorded management fees with respect to this facility amounting to \$18,000, and \$55,000 for the three and nine months ended September 30, 2007, respectively, compared to \$18,000 and \$49,000 for the three and nine months ended September 30, 2006, respectively.

PSB manages certain of the commercial facilities that we own pursuant to management agreements for a management fee equal to 5% of revenues. We paid a total of \$177,000 and \$542,000 for the three and nine months ended September 30, 2007, respectively, as compared to \$147,000 and \$442,000 for the three and nine months ended September 30, 2006, respectively, in management fees with respect to PSB's property management services. At September 30, 2007, included in other liabilities are normal recurring amounts owed to PSB of \$204,000 (\$871,000 at December 31, 2006), for unpaid management fees and certain other operating expenses related to the managed facilities which are initially paid by PSB on our behalf and then reimbursed by us.

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PSB recently acquired commercial facilities which included self-storage space. We are managing this self-storage space for them for a management fee of 6% of revenues. We recorded management fees with respect to these facilities amounting to \$11,000 and \$35,000 for the three and nine months ended September 30, 2007 (none for the same periods in 2006).

Pursuant to a cost-sharing and administrative services agreement, PSB reimburses us for certain administrative services that we provide to them. PSB's share of these costs totaled approximately \$76,000 and \$228,000

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for the three and nine months ended September 30, 2007, respectively, as compared to \$80,000 and \$240,000 for the three and nine months ended September 30, 2006, respectively.

We manage our wholly-owned self-storage facilities as well as the facilities owned by the Consolidated Entities and affiliated entities that are not consolidated on a joint basis, in order to take advantage of scale and other efficiencies. As a result, significant components of self-storage operating costs, such as payroll costs, advertising and promotion, data processing, and insurance expenses are shared and allocated among the various entities using methodologies meant to fairly allocate such costs based upon the related activities. The amount of such expenses allocated to Unconsolidated Entities was approximately \$599,000 and \$1,895,000 for the three and nine months ended September 30, 2007, respectively, as compared to \$503,000 and \$1,770,000 for the three and nine months ended September 30, 2006, respectively.

Stor-RE, a consolidated entity, and third party insurance carriers provided PS Canada, the Company, PSB, and other affiliates of the Company with liability and casualty insurance coverage until March 31, 2004. PS Canada owns a 2.2% interest and PSB owns a 4.0% interest in Stor-RE. PS Canada and PSB obtained their own liability and casualty insurance covering occurrences after April 1, 2004. For occurrences before April 1, 2004, Stor-Re continues to provide liability and casualty insurance coverage consistent with the relevant agreements.

On May 14, 2007, one of our European subsidiaries sold limited liability partner interests ("LLP Interests") it held in Shurgard Europe, also an indirect subsidiary of Public Storage, to various officers of the Company, other than our chief executive officer. The aggregate proceeds of the sale were \$4,909,000. The sale price for the LLP Interests was the net asset value per LLP Interest using, among other items, information provided by an independent third party appraisal firm of the net asset value of Shurgard Europe as of March 31, 2007. The Company has a right to repurchase the LLP Interests (1) upon a purchaser's termination of employment or (2) for any reason, on or after May 14, 2008. The repurchase price is set at the lesser of (1) the then net asset value per share or (2) the original purchase price with a 10% compounded annual return. In connection with the sale of these LLP Interests, we recorded a gain of \$1,193,000 during the three months ended June 30, 2007, representing the excess of the sales proceeds over the book value of the LLP Interests sold. The gain is reflected in gain on disposition of real estate investments on our accompanying condensed consolidated statements of income. The investment of these various officers is included in minority interest - other partnership interests on our accompanying condensed consolidated balance sheet at September 30, 2007 and their pro rata share of the earnings of Shurgard Europe are reflected in minority interest in income - other partnership interests on our accompanying condensed consolidated statements of income for the three and nine months ended September 30, 2007.

### 15. Commitments and Contingencies

#### Legal Matters

Serrao v. Public Storage, Inc. (filed April 2003) (Superior Court  
of California - Orange County)

The plaintiff in this case filed a suit against the Company on

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behalf of a putative class of renters who rented self-storage units from the Company. Plaintiff alleges that the Company misrepresented the size of

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its storage units, has brought claims under California statutory and common law relating to consumer protection, fraud, unfair competition, and negligent misrepresentation, and is seeking monetary damages, restitution, and declaratory and injunctive relief.

Based upon the uncertainty inherent in any putative class action, we cannot presently determine the potential damages, if any, or the ultimate outcome of this litigation. On November 3, 2003, the court granted our motion to strike the plaintiff's nationwide class allegations and to limit any putative class to California residents only. In August 2005, we filed a motion to remove the case to federal court, but the case has been remanded to the Superior Court. We are vigorously contesting the claims upon which this lawsuit is based, including class certification efforts.

Drake v. Shurgard Storage Centers, Inc. (filed September 2002)

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(Superior Court of California - Orange County)  
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This is a companion case to the Serrao matter discussed above. The plaintiff alleges the same set of operative facts and seeks the same relief as in Serrao against Shurgard, whose liability Public Storage assumed following the merger of Public Storage and Shurgard on August 22, 2006. In June 2007, the Court certified a class of all Shurgard renters who rented a storage unit at a Shurgard facility in California that was smaller than represented. The maximum potential liability cannot presently be estimated. We intend to vigorously contest the substantive merits of the class certification while seeking an appellate writ challenging the Court's certifications of the class.

Potter, et al v. Hughes, et al (filed December 2004) (United

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States District Court - Central District of California)  
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In November 2002, a shareholder of the Company made a demand on our Board challenging the fairness of the Company's acquisition of PS Insurance Company, Ltd. ("PSIC") and related matters. PSIC was previously owned by the Hughes Family. In June 2003, following the filing by the Hughes Family of a complaint for declaratory relief asking the court to find that the acquisition of PSIC and related matters were fair to the Company, it was ruled that the PSIC transaction was just and reasonable as to the Company and holding that the Hughes Family was not required to make any payment to the Company.

At the end of December 2004, the same shareholder referred to above and a second shareholder filed this shareholder's derivative complaint naming as defendants the Company's directors (and two former directors) and certain officers of the Company. The matters alleged in this complaint relate to PSIC, the Hughes Family's Canadian self-storage operations and the Company's 1995 reorganization. In July 2006, the Court

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granted the defendants' motion to dismiss the amended Complaint without leave to amend. In August 2006, Plaintiffs filed a notice of appeal of the Court's decision. The appeal is currently pending. We believe the litigation will not have any financially adverse effect on the Company (other than the costs and other expenses relating to the lawsuit).

Brinkley v. Public Storage, Inc. (filed April 2005) (Superior  
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Court of California - Los Angeles County)  
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The plaintiff sued the Company on behalf of a purported class of California non-exempt employees based on various California wage and hour laws and seeking monetary damages and injunctive relief. In May 2006, a motion for class certification was filed seeking to certify five subclasses. Plaintiff sought certification for alleged meal period violations, rest period violations, failure to pay for travel time, failure to pay for mileage reimbursement, and for wage statement violations. In

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October 2006, the Court declined to certify three out of the five subclasses. The Court did, however, certify subclasses based on alleged meal period and wage statement violations. Subsequently, the Company filed a motion for summary judgment seeking to dismiss the matter in its entirety. On June 22, 2007, the Court granted the Company's summary judgment motion as to the causes of action relating to the subclasses certified and dismissed those claims. The only surviving claims are those relating to the named plaintiff only. The plaintiff has filed an appeal to the Court's June 22, 2007 summary judgment ruling.

Simas v. Public Storage, Inc. (filed January 2006) (Superior  
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Court of California - Orange County)  
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The plaintiff brought this action against the Company on behalf of a purported class who bought insurance coverage at the Company's facilities alleging that the Company does not have a license to offer, sell and/or transact storage insurance. The action was originally brought under California Business and Professions Code Section 17200 and seeks retention, monetary damages and injunctive relief. The Company filed a demurrer to the complaint. While the demurrer was pending, the plaintiff amended the complaint to allege a national class and claims for unfair business practices, unjust enrichment, money had and received, and negligent and intentional misrepresentation. Ultimately all claims except for unjust enrichment were dismissed. A subsequent demurrer was filed and sustained without leave to amend. The case was therefore dismissed. The plaintiff has appealed the trial court's ruling.

European Joint Venture Arbitration Proceeding  
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The Company holds indirectly a 20% interest in each of two joint ventures in Europe, First Shurgard and Second Shurgard, that collectively



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own 66 self-storage properties in Europe. On August 24, 2006, the Company, through its affiliate, Shurgard Europe, served an exit notice on the European joint venture partners informing them of its intention to purchase their interests in First Shurgard and Second Shurgard pursuant to an early exit procedure that the Company believes is provided for in the respective joint venture agreements. The exit notice offered to pay the joint venture partners an amount for their interests in accordance with the provisions of the joint venture agreements. The joint ventures partners have contested both the valuation of their interests and whether the Company has the right to purchase its interests under this early exit procedure. Accordingly, it is uncertain as to whether the Company will acquire such interests pursuant to the early exit notice served. On January 17, 2007, Shurgard Europe filed an arbitration request with the International Chamber of Commerce to compel arbitration of the matter. The arbitration proceedings are ongoing.

### Other Items

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We are a party to various claims, complaints, and other legal actions that have arisen in the normal course of business from time to time that are not described above. We believe that it is unlikely that the outcome of these other pending legal proceedings including employment and tenant claims, in the aggregate, will have a material adverse impact upon our operations or financial position.

### Insurance and Loss Exposure

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We have historically carried comprehensive insurance, including property, earthquake, general liability and workers compensation, through nationally recognized insurance carriers and through our captive insurance programs. Our insurance programs also insure affiliates of the Company. Our estimated maximum annual exposure for losses that are below the deductibles set forth in the third-party insurance contracts, assuming multiple significant events occur, is approximately \$37 million. In addition, if losses exhaust the third-party insurers' limit of coverage of \$75 million for property coverage including earthquake coverage ((euro)25 million for Europe) and \$102 million for general liability, our exposure could be greater. These limits are higher than estimates of maximum probable losses that could occur from individual catastrophic events (i.e. earthquake and wind damage) determined in recent engineering and actuarial studies.

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Our tenant insurance program reinsures policies against claims for losses to goods stored by tenants at our self-storage facilities. We have third-party insurance coverage for claims paid exceeding \$1,500,000 resulting from any individual event, to a limit of \$9,000,000. At September 30, 2007, we had approximately 481,000 reinsured policies outstanding representing aggregate coverage of approximately \$1.2 billion.

### Development and Acquisition of Real Estate Facilities

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We currently have 55 projects in our development pipeline, consisting of newly developed self-storage facilities, expansions and

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enhancements to existing self-storage facilities. The total estimated cost of these facilities is approximately \$295 million of which \$103,657,000 has been spent at September 30, 2007. These projects are subject to contingencies. We expect to incur these expenditures over the next 12 - 24 months.

### Operating Lease Obligations

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We lease trucks, land, equipment and office space. At September 30, 2007, the future minimum rental payments required under our operating leases for the years ending December 31, principally representing amounts payable under land leases for our European subsidiaries, are as follows (amounts in thousands):

|                          |            |
|--------------------------|------------|
| 2007 (remainder of)..... | \$ 7,318   |
| 2008.....                | 19,257     |
| 2009.....                | 15,817     |
| 2010.....                | 12,083     |
| 2011.....                | 10,774     |
| Thereafter.....          | 205,398    |
|                          | -----      |
|                          | \$ 270,647 |
|                          | =====      |

We lease trucks, land, equipment and office space under various operating leases. Certain leases are cancelable with substantial penalties. Certain of our European land operating leases have indefinite terms or extension options exercisable at the discretion of the lessee. For such land leases we have disclosed operating lease obligations over the estimated useful life of the related property.

Expenses under operating leases were approximately \$7,397,000 and \$22,168,000 for the three and nine months ended September 30, 2007, respectively, as compared to \$7,482,000 and \$12,052,000 for the three and nine months ended September 30, 2006, respectively. Certain of our land leases include escalation clauses, and we recognize related lease expenses on a straight-line basis.

### 16. Income Taxes

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For all taxable years subsequent to 1980, the Company qualified and we intend to continue to qualify the Company as a REIT, as defined in Section 856 of the Internal Revenue Code. As a REIT, we do not incur federal or significant state tax on that portion of our taxable income which is distributed to our shareholders, provided that we meet certain tests. We believe we will meet these tests during 2007 and, accordingly, no provision for income taxes has been made in the accompanying condensed consolidated financial statements on income produced and distributed on real estate rental operations.

Domestic operations other than rental real estate are primarily conducted through taxable REIT subsidiaries. Income of our taxable REIT subsidiaries is subject to federal, state and local income taxes. We are subject to the income tax provisions of the various European countries in which we have rental real estate operations.

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We adopted the provisions of Financial Accounting Standards Board ("FASB") Interpretation No. 48, "Accounting for Uncertainty in Income Taxes - an interpretation of FASB Statement No. 109" ("FIN 48"), on January 1, 2007. FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statement in accordance with FASB Statement 109, "Accounting for Income Taxes", and prescribes a recognition threshold and measurement process for financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosures and transition.

Based on our evaluation, we have concluded that there are no significant uncertain tax positions requiring recognition in our financial statements. Our evaluation was performed for the tax years ended December 31, 2003, 2004, 2005, 2006 and the first three quarters of 2007.

We may from time to time be assessed interest or penalties by certain tax jurisdictions, although any such assessments have historically been minimal and immaterial to our financial results. In the event we have received an assessment for interest and/or penalties, it has been classified in the financial statements as general and administrative expense.

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### ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion and analysis should be read in conjunction with our condensed consolidated financial statements and notes thereto.

**Forward Looking Statements:** All statements in this document, other than statements of historical fact, are forward-looking statements which may be identified by the use of the words "expects," "believes," "anticipates," "plans," "would," "should," "may," "estimates" and similar expressions. These forward-looking statements are made pursuant to the safe-harbor provisions of Section 21E of the Securities Exchange Act of 1934, as amended, and Section 27A of the Securities Act of 1933, as amended. These forward-looking statements involve known and unknown risks and uncertainties, which may cause Public Storage's actual results and performance to be materially different from those expressed or implied in the forward-looking statements. As a result, you should not rely on these forward-looking statements as predictions of future events.

Factors and risks that may impact future results and performance include, but are not limited to, those described in Item 1A, "Risk Factors" in the Public Storage, Inc. Annual Report on Form 10-K for the year ended December 31, 2006 and in our other filings with the Securities and Exchange Commission. These risks include the following: changes in general economic conditions and in the markets in which we operate; the impact of competition from new and existing storage and commercial facilities and other storage alternatives; difficulties in our ability to successfully evaluate, finance and integrate acquired and developed properties into our existing operations; risks associated with international operations; the impact of the regulatory environment as well as national, state, and local laws and regulations including, without limitation, those governing REITs; difficulties in raising capital at reasonable rates;

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delays in the development process; and economic uncertainty due to the impact of war or terrorism.

We caution you not to place undue reliance on forward-looking statements, which speak only as the date of this report or as of the dates indicated in the statements. All of our forward looking statements, including those in this report, are qualified in their entirety by this statement. We assume no obligation to update publicly or otherwise revise any forward-looking statements, whether as a result of new information, new estimates, or other factors, events or circumstances after the date of this document, except where expressly required by law.

### CRITICAL ACCOUNTING POLICIES

Management's Discussion and Analysis of Financial Condition and Results of Operations discusses our consolidated financial statements, which have been prepared in accordance with U.S. generally accepted accounting principles ("GAAP"). The preparation of our financial statements and related disclosures in conformity with GAAP and our discussion and analysis of our financial condition and results of operations requires management to make judgments, assumptions and estimates that affect the amounts reported in our consolidated financial statements and accompanying notes. Note 2 to our condensed consolidated financial statements summarizes the significant accounting policies and methods used in the preparation of our condensed consolidated financial statements and related disclosures.

Management believes the following are critical accounting policies whose application has a material impact on the Company's financial presentation. That is, they are both important to the portrayal of our financial condition and results, and they require management to make judgments and estimates about matters that are inherently uncertain.

**QUALIFICATION AS A REIT - INCOME TAX EXPENSE:** We believe that we have been organized and operated, and we intend to continue to operate, as a qualifying Real Estate Investment Trust ("REIT") under the Internal Revenue Code and applicable state laws. We also believe that Shurgard qualified as a REIT. A qualifying REIT generally does not pay corporate level income taxes on its taxable income that is distributed to its shareholders, and accordingly, we do not pay income tax on the share of our taxable income that is distributed to our shareholders.

We therefore do not estimate or accrue any federal income tax expense for income earned and distributed related to REIT operations. This estimate could be

incorrect, because due to the complex nature of the REIT qualification requirements, the ongoing importance of factual determinations and the possibility of future changes in our circumstances, we cannot be assured that we actually have satisfied or will satisfy the requirements for taxation as a REIT for any particular taxable year. For any taxable year that we fail or have failed to qualify as a REIT and applicable relief provisions did not apply, we would be taxed at the regular corporate rates on all of our taxable income, whether or not we made or make any distributions to our shareholders. Any resulting requirement to pay corporate income tax, including any applicable penalties or interest, could have a material adverse impact on our financial condition or results of operations. Unless entitled to relief under specific statutory provisions, we also would be disqualified from taxation as a REIT for the four taxable years following the year during which qualification was lost. There can be no assurance that we would be entitled to any statutory relief. In addition, if Shurgard failed to qualify as a REIT, we generally would have

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succeeded to or incurred significant tax liabilities.

**IMPAIRMENT OF LONG-LIVED ASSETS:** Substantially all of our assets consist of long-lived assets, including real estate and other intangible assets. The evaluation of our long-lived assets for impairment includes determining whether indicators of impairment exist, which is a subjective process. When any indicators of impairment are found, the evaluation of such long-lived assets then entails projections of future operating cash flows, which also involves significant judgment. Future events, or facts and circumstances that currently exist, that we have not yet identified, could cause us to conclude in the future that our long-lived assets are impaired. Any resulting impairment loss could have a material adverse impact on our financial condition and results of operations.

**ESTIMATED USEFUL LIVES OF LONG-LIVED ASSETS:** Substantially all of our assets consist of depreciable, long-lived assets. We record depreciation expense with respect to these assets based upon their estimated useful lives. Any change in the estimated useful lives of those assets, caused by functional or economic obsolescence or other factors, could have a material adverse impact on our financial condition or results of operations.

**ESTIMATED LEVEL OF RETAINED RISK AND UNPAID TENANT CLAIM LIABILITIES:** As described in Notes 2 and 15 to our condensed consolidated financial statements, we retain certain risks with respect to property perils, legal liability, and other such risks. In addition, a wholly-owned subsidiary of the Company reinsures policies against claims for losses to goods stored by tenants in our self-storage facilities. In connection with these risks, we accrue losses based upon the estimated level of losses incurred using certain actuarial assumptions followed in the insurance industry and based on recommendations from an independent actuary that is a member of the American Academy of Actuaries. While we believe that the amounts of the accrued losses are adequate, the ultimate liability may be in excess of or less than the amounts recorded. At September 30, 2007, we had approximately 481,000 reinsured policies in the United States outstanding representing aggregate coverage of approximately \$1.2 billion.

**ACCRUALS FOR CONTINGENCIES:** We are exposed to business and legal liability risks with respect to events that have occurred, but in accordance with GAAP, we have not accrued for such potential liabilities because the loss is either not probable or not estimable or because we are not aware of the event. Future events and the result of pending litigation could result in such potential losses becoming probable and estimable, which could have a material adverse impact on our financial condition or results of operations. Some of these potential losses, of which we are aware, are described in Note 15 to our condensed consolidated financial statements.

**ACCRUALS FOR OPERATING EXPENSES:** We accrue for property tax expense and certain other operating expenses based upon estimates and historical trends and current and anticipated local and state government rules and regulations. If these estimates and assumptions are incorrect, our expenses could be misstated. Cost of operations, interest expense, general and administrative expense, as well as television, yellow page, and other advertising expenditures are expensed as incurred.

**VALUATION OF DERIVATIVES:** As described in our Significant Accounting Policies in Note 2 to our condensed consolidated financial statements, our derivative instruments are not considered effective hedges. Accordingly, any changes in value of these derivatives are reflected as an increase or decrease in net income. The determination of the value of derivatives is based upon significant judgment and assumptions including interest rates, currency rates, and expected rates of return. The actual value of derivative instruments is dependent upon many factors that our judgments and assumptions may not consider, or may not consider effectively.

EUROPEAN NET OPERATING LOSSES - INCOME TAX TREATMENT: The Shurgard European real estate operations generated significant operating losses from inception to the date of our merger with Shurgard. We recorded a deferred tax asset arising from the net operating loss carryforward as of the date of acquisition, and concluded that a valuation allowance was required for the net amount of the deferred tax asset. To the extent that we determine the valuation allowance is no longer required, the change in the valuation allowance will first be treated as a reduction of goodwill and other intangible assets related to the Shurgard merger before being treated as a reduction to the provision for income taxes.

VALUATION OF ASSETS AND LIABILITIES ACQUIRED IN THE MERGER WITH SHURGARD: In recording the merger with Shurgard, we have estimated the fair market value of real estate, intangible assets, debt, and the other assets and other liabilities of Shurgard that we acquired. In addition, we have estimated the fair market value of the 38.9 million shares that we issued to the Shurgard shareholders. These value estimates are based upon many assumptions, including interest rates, market values of land and buildings in the United States and Europe, estimated future cash flows from the tenant base in place, and the recoverability of certain assets. While we believe that the assumptions we used are reasonable, these assumptions are subject to a significant degree of judgment, and others could come to materially different conclusions as to value. If these assumptions were computed differently, our depreciation and amortization expense, interest expense, real estate, debt, and intangible assets could be materially different.

#### RESULTS OF OPERATIONS

FOR THE THREE MONTHS ENDED SEPTEMBER 30, 2007:

Net income for the three months ended September 30, 2007 was \$152,766,000 compared to \$81,181,000 for the same period in 2006, representing an increase of \$71,585,000. This increase in net income is primarily due to a foreign currency exchange gain, reduction in general and administrative expense and improved operations from our real estate facilities. These factors were partially offset by increased depreciation and amortization expense.

Comparisons of our revenues, expenses, and weighted average shares outstanding are significantly impacted by the merger with Shurgard, which closed on August 23, 2006. The operating results with respect to the assets and liabilities acquired in the merger with Shurgard are included in our operating results from August 23, 2006 through September 30, 2006 during the quarter ended September 30, 2006, as compared to the entire quarter ended September 30, 2007.

During the quarter ended September 30, 2007, we recognized a foreign currency exchange gain of \$30.4 million relating to intercompany loans between our U.S. and European subsidiaries. The gain was the result of the continued weakening of the US Dollar relative to the Euro during the quarter. See "Foreign Exchange Gain" below for further information.

General and administrative expense declined \$24.8 million in the quarter ended September 30, 2007 as compared to the same period in 2006. This decline was primarily due to the reduction in integration expenses associated with the Shurgard merger, contract termination costs, and development costs that were expensed with respect to terminated projects; these expenses aggregated \$29.6 million in the quarter ended September 30, 2006 as compared to \$1.4 million for the same period in 2007.

Our Same Store net operating income, before depreciation expense, increased

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by approximately \$2,901,000 to \$161,374,000, or 1.8%, as a result of a 1.7% improvement in revenues partially offset by a 1.5% increase in cost of operations. Aggregate net operating income for our newly developed, recently expanded and acquired facilities (other than the Shurgard facilities) increased by approximately \$4,368,000 to \$30,208,000 compared to the same period in 2006. This increase was largely due to the impact of facilities acquired in 2005, 2006 and 2007, combined with continued fill-up of our newly developed and expansion facilities.

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For those facilities that were acquired in the Shurgard merger, net operating income was approximately \$92,996,000 for the quarter ended September 30, 2007 as compared to \$35,363,000 (which reflects the operations of these facilities from August 23, 2006 through September 30, 2006) for the same period in 2006.

Depreciation and amortization expense for the quarter ended September 30, 2007 increased by \$34.3 million, as compared to the same period in 2006. This increase is primarily due to increased depreciation and amortization expense with respect to the buildings and intangible assets acquired in the merger with Shurgard.

For the three months ended September 30, 2007, net income allocable to our common shareholders (after allocating net income to our preferred and equity shareholders) was \$87,077,000 or \$0.51 per common share on a diluted basis compared to a net loss of \$6,083,000 or \$0.04 per common share on a diluted basis for the same period in 2006, representing an increase of \$93,160,000 or \$0.55 per diluted common share. The increase in net income allocable to common shareholders on an aggregate and per-share basis is due primarily to the impact of the factors described above, combined with a decrease in income allocated to preferred shareholders, as described below.

For the three months ended September 30, 2007 and 2006, we allocated \$60,333,000 and \$60,265,000 of our net income, respectively, to our preferred shareholders based on distributions paid. The year-over-year increase is due to the issuance of additional preferred securities, partially offset by the redemption of preferred securities that had higher dividend rates than the newly issued preferred securities. In 2006, we also recorded allocations of income to our preferred shareholders with respect to the application of EITF Topic D-42, totaling \$21,643,000 (or \$0.15 per diluted common share) for the three months ended September 30, 2006 in connection with the redemption of preferred securities.

Weighted average diluted shares increased to 170,085,000 for the three months ended September 30, 2007 from 145,387,000 for the three months ended September 30, 2006. The increase in weighted average diluted shares is due primarily to the impact of the issuance of 38.9 million shares in connection with our merger with Shurgard, with approximately 16.7 million of such shares being included in our operating results for the quarter ended September 30, 2006 (representing the weighted average outstanding of such shares from August 23, 2006 through September 30, 2006). The increase also includes the weighted average impact of the exercise of approximately 1.8 million stock options issued in connection with the merger with Shurgard principally during the quarter ended September 30, 2006.

FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2007:

Net income for the nine months ended September 30, 2007 was \$289,648,000 compared to \$324,259,000 for the same period in 2006, representing a decrease of \$34,611,000. This decrease is primarily due to a \$279.7 million increase in

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depreciation and amortization expense, due primarily to depreciation and amortization with respect to the buildings and intangibles acquired in the merger with Shurgard. Increased depreciation and amortization expense was partially offset by a foreign currency exchange gain of \$41.0 million and improved operations from our real estate facilities.

Comparisons of our revenues, expenses, and weighted average shares outstanding are significantly impacted by the merger with Shurgard, which closed on August 23, 2006. The results with respect to the assets and liabilities acquired in the merger with Shurgard are included in our operating results from August 23, 2006 through September 30, 2006 during the nine months ended September 30, 2006, as compared to the entire nine months ended September 30, 2007.

During the nine months ended September 30, 2007, we recognized a foreign currency exchange gain aggregating \$41.0 million relating to intercompany loans between our U.S. and European subsidiaries. The gain was the result of the continued weakening of the US Dollar relative to the Euro during the nine month period ended September 30, 2007. See "Foreign Exchange Gain" below for further information.

Same Store net operating income, before depreciation expense, increased by \$9,479,000 to \$461,150,000, or 2.1%, as a result of a 2.1% improvement in

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revenues partially offset by a 2.1% increase in cost of operations. Aggregate net operating income for our newly developed, recently expanded and acquired self-storage facilities (excluding the Shurgard facilities) increased by approximately \$12,090,000 to \$81,213,000.

For those facilities that were acquired in the Shurgard merger, net operating income was approximately \$253,926,000 for the nine months ended September 30, 2007, as compared to \$35,363,000 (which reflects the operations of these facilities from August 23, 2006 through September 30, 2006) for the same period in 2006.

Net income allocable to our common shareholders (after allocating net income to our preferred and equity shareholders) was \$97,156,000 or \$0.57 per common share on a diluted basis for the nine months ended September 30, 2007 compared to \$127,292,000 or \$0.94 per common share on a diluted basis for the same period in 2006, representing a decrease of \$0.37 per common share, or 39.4%. The decrease in net income allocable to common shareholders and earnings per common diluted share are due primarily to the impact of the factors described above, partially offset by a decrease in income allocated to preferred shareholders, as described below.

For the nine months ended September 30, 2007 and 2006, we allocated \$176,424,000 and \$159,256,000 of our net income, respectively, to our preferred shareholders based on distributions paid. The year-over-year increase is due to the issuance of additional preferred securities, partially offset by the redemption of preferred securities that had higher dividend rates than the newly preferred securities issued. In 2006, we also recorded allocations of income to our preferred shareholders with respect to the application of EITF Topic D-42, totaling \$21,643,000 (or \$0.16 per diluted common share) for the nine months ended September 30, 2006 in connection with the redemption of preferred securities.

Weighted average diluted shares increased to 170,166,000 for the nine months ended September 30, 2007 from 134,851,000 for the nine months ended September 30, 2006. The increase in weighted average diluted shares is due



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primarily to the impact of the issuance of 38.9 million shares in connection with our merger with Shurgard, with approximately 5.6 million of such shares being included in our operating results for the quarter ended September 30, 2006 (representing the weighted average outstanding of such shares from August 23, 2006 through September 30, 2006) and all such shares included in our weighted average shares for the same period in 2007. The increase also includes the weighted average impact of the exercise of approximately 1.8 million stock options issued in connection with the merger with Shurgard principally during the quarter ended September 30, 2006.

### REAL ESTATE OPERATIONS

**DOMESTIC SELF-STORAGE OPERATIONS:** Our domestic self-storage operations are by far the largest component of our operating activities, representing approximately 81% of our total revenues generated for each of the three and nine month periods ended September 30, 2007. Rental income with respect to our domestic self-storage operations has grown from \$311 million and \$825 million for the three and nine months ended September 30, 2006, respectively, to \$378 million and \$1,098 million for the three and nine months ended September 30, 2007, respectively, representing increases of \$67 million, or approximately 22% for the three months ended September 30, 2007 and \$273 million, or approximately 33% for the nine months ended September 30, 2007. The year-over-year improvements in rental income are due to improvements in the performance of those facilities that we owned prior to January 1, 2005 (our "Same Store" facilities), and the addition of new facilities to our portfolio, either through our acquisition or development activities.

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To enhance year-over-year comparisons, the following table summarizes, and the ensuing discussion describes the operating results of these three groups, our Same Store group, acquisition facilities and development facilities.

| Domestic Self - Storage Operations Summary:                     | Three Months Ended |            |                      | Nin   |
|---|--------------------|------------|----------------------|-------|
| -----   | September 30,      |            |                      | Sep   |
|   | 2007               | 2006       | Percentage<br>Change | 200   |
| -----   | -----              | -----      | -----                | ----- |
| (Dollar amounts in thousands)                                   |                    |            |                      |       |
| Rental income:  |                    |            |                      |       |
| Same Store Facilities - Public Storage.....                     | \$ 237,434         | \$ 233,420 | 1.7                  | \$ 69 |
| Same Store Facilities - Shurgard.....                           | 69,313             | 27,876     | 148.6%               | 20    |
| Other Facilities.....   | 71,130             | 50,138     | 41.9%                | 20    |
|   | -----              | -----      | ----                 | ----- |
| Total rental income.....  | 377,877            | 311,434    | 21.3%                | 1,09  |
|   | -----              | -----      | ----                 | ----- |
| Cost of operations before depreciation and<br>amortization (a): |                    |            |                      |       |
| Same Store Facilities - Public Storage.....                     | 76,060             | 74,947     | 1.5%                 | 232   |
| Same Store Facilities - Shurgard.....                           | 21,818             | 8,516      | 156.2%               | 67    |
| Other Facilities.....   | 24,071             | 17,119     | 40.6%                | 74    |
|   | -----              | -----      | ----                 | ----- |
| Total cost of operations.....                                   | 121,949            | 100,582    | 21.2%                | 374   |
|   | -----              | -----      | ----                 | ----- |
| Net operating income before depreciation and                    |                    |            |                      |       |

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|   |                     |                     |                |                 |
|---|---------------------|---------------------|----------------|-----------------|
| amortization(a):  |                     |                     |                |                 |
| Same Store Facilities - Public Storage.....                                 | 161,374             | 158,473             | 1.8%           | 461             |
| Same Store Facilities - Shurgard.....                                       | 47,495              | 19,360              | 145.3%         | 133             |
| Other Facilities.....   | 47,059              | 33,019              | 42.5%          | 128             |
| Total net operating income before<br>depreciation and amortization (a)..... | -----<br>255,928    | -----<br>210,852    | -----<br>21.4% | -----<br>723    |
| Depreciation and amortization expense:                                      |                     |                     |                |                 |
| Same Store Facilities - Public Storage.....                                 | (40,553)            | (41,294)            | (1.8)%         | (121)           |
| Same Store Facilities - Shurgard.....                                       | (44,595)            | (35,304)            | 26.3%          | (161)           |
| Other Facilities.....   | (29,817)            | (21,036)            | 41.7%          | (95)            |
| Total depreciation and amortization expense.                                | -----<br>(114,965)  | -----<br>(97,634)   | -----<br>17.8% | -----<br>(378)  |
| Net operating income (loss):  |                     |                     |                |                 |
| Same Store Facilities - Public Storage.....                                 | 120,821             | 117,179             | 3.1%           | 339             |
| Same Store Facilities - Shurgard.....                                       | 2,900               | (15,944)            | (118.2)%       | (28)            |
| Other Facilities.....   | 17,242              | 11,983              | 43.9%          | 33              |
| Total net operating income.....   | -----<br>\$ 140,963 | -----<br>\$ 113,218 | -----<br>24.5  | -----<br>\$ 344 |
| Weighted average square foot occupancy during<br>the period.....            |                     |                     |                |                 |
|   | 89.2%               | 88.4%               | 0.9%           | 8               |
| Number of self-storage facilities (at end of<br>period).....                |                     |                     |                |                 |
|   |                     |                     |                | 1               |
| Net rentable square feet (in thousands, at end<br>of period):.....          |                     |                     |                |                 |
|   |                     |                     |                | 124             |

(a) Total net operating income before depreciation and amortization or "NOI" is a non-GAAP (generally accepted accounting principles) financial measure that excludes the impact of depreciation and amortization expense. See Note 12 to our September 30, 2007 condensed consolidated financial statements, "Segment Information," which includes a reconciliation of net operating income before depreciation and amortization for this segment to our consolidated net income. Although depreciation and amortization are operating expenses, we believe that NOI is a meaningful measure of operating performance, because we utilize NOI in making decisions with respect to capital allocations, in determining current property values, segment performance, and comparing period-to-period and market-to-market property operating results. NOI is not a substitute for net operating income after depreciation and amortization in evaluating our operating results.

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In the discussion that follows, we present realized annual rent per occupied square foot, which is computed by dividing rental income, before late charges and administrative fees, by the weighted average occupied square footage for the period. We also present annualized rental income per available square foot ("REVPAF"), which represents annualized rental income, before late charges and administrative fees, divided by total available net rentable square feet. Late charges and administrative fees are excluded to more effectively measure our ongoing level of revenue associated with the leasing of the units.

In the above table, the significant increases in revenues and cost of operations, in the three and nine months ended September 30, 2007 as compared to the same periods in 2006, are primarily due to the acquisition of self-storage facilities in connection with the merger with Shurgard which was completed on August 23, 2006 (see Note 3 to the condensed consolidated financial statements). As a result of the merger, we acquired interests in 487 self-storage facilities

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(32.3 million net rentable square feet) located in the United States, including 459 wholly-owned facilities and 28 facilities owned by joint ventures in which we have an interest. Effective May 24, 2007, due to a loss in control of certain partnerships, we began deconsolidating 11 of these facilities containing 624,000 net rentable square feet. Included in the line item "Other Facilities" in the table above is the operating data with respect to these 11 facilities from August 23, 2006 through May 24, 2007. The operating results of all of the other facilities acquired in the merger and located in the United States are included in our financial statements and in the above table for the period we owned the facilities.

Immediately preceding the close of the merger, all of the acquired facilities in the United States were integrated into our property management systems, centralized pricing systems, national call center, and website. Temporary signage, re-branding the facilities from "Shurgard" to "Public Storage", was also put into place immediately after the close of the merger.

Our property management personnel worked diligently to absorb this large acquisition of facilities. Training and hiring new property managers were key elements for the successful integration process. New employees needed to be trained on how to use our property management systems and follow our operating policies and procedures. As expected in a merger of this nature, immediately following the close of the merger, turnover at the property manager level was higher than we normally experience. In anticipation of such turnover, we began to hire additional "bench" property managers in the second quarter of 2006 to fill openings when turnover occurred. Although this strategy was effective at keeping properties opened for business, it did result in incurring additional payroll costs in the second, third and fourth quarters of 2006 due to the additional head count.

As a result of the merger, the amount of vacant space increased significantly in our system. The acquired Shurgard portfolio of 487 facilities in the United States had aggregate average square foot occupancy of 84.4% at August 31, 2006, which was 530 basis points below the 89.7% for the existing Public Storage portfolio. Average rental rates were approximately the same for each of the portfolios. Our goal has been to increase our overall portfolio occupancy in order to be in a position to drive rental rates. The primary focus in meeting our goal has been to work to improve the Shurgard portfolio's overall occupancy level to the occupancy level experienced by our existing portfolio.

In order to increase move-in volumes and ultimately increase occupancy levels as quickly as possible, and because there is typically low seasonal demand in the fourth and first quarters, we were much more aggressive at reducing our pricing, and increasing promotional discounts and marketing programs during the fourth quarter of 2006 and continued doing so during the first nine months of 2007. We have substantially increased our media advertising expenditures to \$5.2 million and \$21.8 million for the three and nine months ended September 30, 2007 as compared to \$1.6 million and \$10.2 million, respectively, in the same periods in 2006.

We have made significant progress in improving the occupancy level of the Shurgard portfolio. However, this improvement has come somewhat at the expense of in a reduction in the Public Storage Same Store Facilities' occupancies and reduced growth in rates. We believe that the more aggressive pricing and discounting at the Shurgard properties, combined with the fact that the Shurgard properties have relatively more vacant spaces to rent, has resulted in shifting of new tenant flow not only from our competitors, but also from our existing portfolio to the Shurgard properties during the past nine months, putting some pressure on occupancies and rental rate growth for the Public Storage Same Store Facilities.

Short-term occupancy increases, like those we have experienced in the

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Shurgard portfolio, tend to result in a higher proportion of short-term tenants and a resulting increase in move-out ratios, which subsides over time. We believe this is related to the nature of the occupancy stabilization process, which we have observed to have two principal stages -- first, the physical fill-up of the facilities, then the achievement of a stable tenant base with historical levels of move-outs, as successive groups of tenants move in, the tenants in such groups with short-term needs (such as moving) move out, and the tenants with long-term storage needs remain.

Until recently, it has been difficult to see the benefits of the strategy we are employing to increase occupancies in our short-term operating results,

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because promotional discounts and marketing expense adversely affect earnings in the month the customer moves in, while the revenue from these tenants are reflected in our operating results throughout their tenancy.

However, as the occupancies of the Shurgard Same Store Facilities have approached the Public Storage historical levels for the last two quarters, we believe we are close to achieving a tenant base with historical move-out rates. As a result, the more aggressive pricing and discounting at the Shurgard Same Store Facilities has begun to subside, providing rental rate growth and putting less pressure on the Public Storage Same Store Facilities. Realized rent per occupied square foot for the Shurgard Same Store Facilities for the quarter ended September 30, 2007 was 1.2% higher as compared to the same period in 2006 (compared to a 1.3% reduction during the first six months of 2007 as compared to the same period in 2006). We believe that achieving our goal of high occupancies with a stabilized tenant base will continue to positively impact our future operating income by a) allowing us to reduce customer acquisition costs such as advertising and promotion, as we will have to attract fewer new tenants to replace vacating tenants and b) allowing us to be more aggressive in raising rental rates to new and existing tenants.

In addition to our strategy to increase Shurgard occupancies, our operating results have been, and will continue to be, impacted by the general economic trends that affect the self-storage business. While it is difficult to quantify the impact of these economic trends, and even more difficult to predict what the impact will be in the future, we do believe that several such factors, including the slowdown in the national housing market as well as reduced year-over-year demand in markets which had enhanced self-storage demand in 2005 and 2006 due to the hurricanes (such as in Florida), have impacted our operating results.

We expect to continue with aggressive pricing, promotional discounts and marketing in the fourth quarter to continue to drive improvement in our overall occupancy levels. We expanded our media programs in the third quarter of 2007 and were on television in approximately 24 markets versus 14 markets in the third quarter of 2006. Future media advertising expenditures are not determinable at this time, and will be driven in part by demand for our self-storage spaces, our current occupancy levels, as well as our evaluation of the most effective mix of yellow page, media, and Internet advertising.

We continue to believe that the acquisition of the Shurgard portfolio provides operational efficiencies, specifically in the areas of marketing, national call center, and indirect overhead costs that support the operations of the facilities. We do not believe that these efficiencies are fully realized and reflected in our operating results due to the recent integration, increased property manager head count and increased marketing costs, as noted above.

SAME STORE FACILITIES - PUBLIC STORAGE

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The facilities included in the Public Storage Same Store Facilities are all stabilized and have been owned since January 1, 2005 and therefore provide meaningful comparative data for 2006 and 2007. The Public Storage Same Store Facilities contain approximately 77.8 million net rentable square feet, representing approximately 63% of the aggregate net rentable square feet of our consolidated domestic self-storage portfolio. Revenues and operating expenses with respect to this group of properties are set forth in the above Self-Storage Operations table under the caption, "Same Store Facilities - Public Storage." The following table sets forth additional operating data with respect to the Same Store Facilities:

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| SAME STORE FACILITIES - PUBLIC STORAGE<br>-----                    | Three Months Ended                                    |            | Percentage<br>Change |
|--|---|------------|----------------------|
|  | 2007  | 2006       |                      |
|  | September 30,   |            |                      |
|  | (Dollar amounts in thousands, except where indicated) |            |                      |
| Rental income.....   | \$ 226,794  | \$ 222,884 | 1.8%                 |
| Late charges and administrative fees collected.....                | 10,640  | 10,536     | 1.0%                 |
|  | 237,434   | 233,420    | 1.7%                 |
| Cost of operations before depreciation and amortization:           |   |            |                      |
| Direct property payroll.....                                       | 15,433  | 16,528     | (6.6)%               |
| Property taxes.....  | 22,718  | 21,700     | 4.7%                 |
| Repairs and maintenance.....                                       | 7,924   | 7,319      | 8.3%                 |
| Advertising and promotion.....                                     | 5,947   | 4,772      | 24.6%                |
| Utilities.....   | 5,583   | 5,582      | 0.0%                 |
| Property insurance.....  | 2,104   | 3,021      | (30.4)%              |
| Telephone reservation center.....                                  | 1,995   | 2,155      | (7.4)%               |
| Other cost of management.....                                      | 14,356  | 13,870     | 3.5%                 |
|  | 76,060  | 74,947     | 1.5%                 |
| Net operating income before depreciation and amortization (e)..... | 161,374   | 158,473    | 1.8%                 |
| Depreciation and amortization.....                                 | (40,553)  | (41,294)   | (1.8)%               |
|  | \$ 120,821  | \$ 117,179 | 3.1%                 |
|  | 68.0%   | 67.9%      | 0.1%                 |
| Gross margin (before depreciation and amortization)                |   |            |                      |
| Weighted average for the fiscal year:                              |   |            |                      |
| Square foot occupancy (a).....                                     | 90.5%   | 91.3%      | (0.9)%               |
| Realized annual rent per occupied square foot (b)                  | \$ 12.89  | \$ 12.55   | 2.7%                 |
| REVPAF (c).....  | \$ 11.66  | \$ 11.46   | 1.7%                 |
| Weighted average at September 30:                                  |   |            |                      |
| Square foot occupancy.....   |   |            |                      |
| In place annual rent per occupied square foot (d)                  |   |            |                      |
| Total net rentable square feet (in thousands).....                 |   |            |                      |
| Number of facilities.....  |   |            |                      |

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- (a) Square foot occupancies represent weighted average occupancy levels over the entire period.
- (b) Realized annual rent per occupied square foot is computed by dividing rental income, prior to late charges and administrative fees, by the weighted average occupied square footage for the period. Realized annual rent per occupied square foot takes into consideration promotional discounts, credit card fees and other costs that reduce rental income from the contractual amounts due.
- (c) Annualized rental income per available square foot ("REVPAF") represents annualized rental income, prior to late charges and administrative fees, divided by total available net rentable square feet.
- (d) In place annual rent per occupied square foot represents annualized contractual rents per occupied square foot without reductions for promotional discounts, and excludes late charges and administrative fees.
- (e) Total net operating income before depreciation and amortization or "NOI" is a non-GAAP (generally accepted accounting principles) financial measure that excludes the impact of depreciation and amortization expense, for our Same Store facilities represents a portion of our total self-storage segment's net operating income before depreciation and amortization, and is reconciled to the segment total in the table "domestic self-storage operations summary" above. A reconciliation of our total self-storage segment's net operating income before depreciation and amortization to consolidated net income is included in Note 12 to our September 30, 2007 condensed consolidated financial statements, "Segment Information." Although depreciation and amortization are operating expenses, we believe that NOI is a meaningful measure of operating performance, because we utilize NOI in making decisions with respect to capital allocations, in determining current property values, segment performance, and comparing period-to-period and market-to-market property operating results. NOI is not a substitute for net operating income after depreciation and amortization in evaluating our operating results.

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Rental income increased approximately 1.7% and 2.1% in the three and nine months ended September 30, 2007 as compared to the same periods in 2006. These increases were primarily attributable to higher average realized annual rental rates per occupied square foot, which were 2.7% and 2.8% higher in the three and nine months ended September 30, 2007 as compared to the same periods in 2006, offset partially by lower occupancy levels.

In the beginning of 2006, the quarterly year-over-year growth in rental income was consistent for each quarter, as rental income growth was 5.5% for the quarter ended March 31, 2006, and started accelerating to 5.9% for the quarter ended June 30, 2006 and 6.3% for the quarter ended September 30, 2006. For the quarter ended December 31, 2006, the year-over-year growth in rental income slowed to 3.5%. In 2007, rental income for the quarters ended March 31, 2007, June 30, 2007 and September 30, 2007 were 2.9%, 1.7% and 1.7%, respectively. This reduction in growth was the result of lower occupancy levels combined with a reduction in year-over-year growth in realized rents.

It is difficult for us to pinpoint the exact causes for this slow down and the degree to which such causes have negatively affected the growth in rental income. We believe, however, that the reduction was due to a number of factors including; (i) the increased number of vacant spaces added to our overall system as a result of the Shurgard merger and our aforementioned focus on improving the

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occupancies of the Shurgard portfolio, (ii) hurricane activity that created unusual demand for storage space in our Florida markets in 2005 and 2004, making year-over-year trends in 2007 less favorable, (iii) general economic conditions, specifically the slow down in housing sales and moving activity, and (iv) increased competition. Many of these factors are beyond our control.

As indicated above, it has been our objective to close the occupancy gap between the acquired Shurgard properties versus the Public Storage existing portfolio and achieve a stabilized tenant base. We believe that this strategy has put pressure on occupancies and rental rate growth on our existing Same Store facilities since the merger, as demand appears to have shifted somewhat to the acquired Shurgard facilities as we have adjusted the level of discounts and monthly rents at the acquired Shurgard facilities to accelerate occupancy growth. Because it was important for us to maintain our occupancy levels in the Public Storage Same Store portfolio, we adjusted rental rates and the level of promotional discounts offered to new tenants as a means to expand move-in volumes throughout the entire portfolio. It has been challenging to maintain occupancy levels at our Same Store group of facilities, while at the same time trying to continue to improve the occupancy levels of the acquired Shurgard facilities and achieve a stabilized tenant base.

However, since we believe that we have now closed the occupancy gap between the acquired Shurgard properties versus the Public Storage existing portfolio and have achieved a stabilized tenant base, we expect that the pressure on Public Storage Same Store portfolio should subside. Despite this positive development, the other aforementioned factors noted above may still continue to have a negative impact on our revenue growth, and as a result it is unclear as to when we may achieve substantially higher levels of revenue growth in the Public Storage Same Store pool than we have been achieving so far in 2007.

Cost of operations (excluding depreciation and amortization) increased by 1.5% and 2.1% in the three and nine months ended September 30, 2007 as compared to the same periods in 2006.

Payroll expense has decreased by 6.6% and 2.1% in the three and nine months ended September 30, 2007 as compared to the same periods in 2006. The decrease experienced is primarily due to a reduction in payroll hours incurred resulting from improved staffing levels, over-staffing in the second and third quarters of 2006 due to the accelerated hiring of "bench" property managers in anticipation of the Shurgard merger, offset partially by higher wage rates.

Property tax expense increased 4.7% and 4.3% in the three and nine months ended September 30, 2007, respectively, as compared to the same periods in 2006, due to higher assessments.

Repairs and maintenance expenditures increased 8.3% and 0.6% in the three and nine months ended September 30, 2007, respectively. We expect repairs and maintenance expenditures to be higher in the remainder of 2007 as compared to the same period in 2006.

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Advertising and promotion is comprised principally of media (television and radio), yellow page, and Internet advertising. Our Same Stores pro rata share of advertising and promotion costs increased 24.6% and 16.2% in the three and nine months ended September 30, 2007 as compared to the same periods in 2006.

Media advertising for the Same Store properties increased from \$1,049,000 in the three months ended September 30, 2006 to \$2,885,000 in the three months ended September 30, 2007. We expect to continue with aggressive pricing, promotional discounts and marketing in the fourth quarter to continue to drive

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improvement in our overall occupancy levels, however, comparisons to prior year with respect to marketing and advertising should be more favorable in the fourth quarter because we significantly increased our television advertising in the fourth quarter of 2006 as compared to the third quarter of 2006. Future media advertising expenditures are not determinable at this time, and will be driven in part by demand for our self-storage spaces, our current occupancy levels, as well as our evaluation of the most effective mix of yellow page, media, and Internet advertising.

Our Internet advertising expenses decreased from \$828,000 for the three months ended September 30, 2006 to \$687,000 for the same period in 2007 and increased from \$2,167,000 for the nine months ended September 30, 2006 to \$2,234,000 for the same period in 2007. We expect that Internet advertising will continue to grow as that marketing channel becomes a more important source of new tenants.

Yellow page advertising expenditures for the Public Storage Same Store portfolio decreased from \$2,134,000 and \$6,777,000 in the three and nine months ended September 30, 2006 to \$1,839,000 and \$6,148,000 in the three months and nine months ended September 30, 2007, respectively. The decrease is a result of certain efficiencies related to the merger with Shurgard, specifically the allocation of costs over a larger pool of properties.

Utility expenses remained flat for the three ended September 30, 2007 and increased from \$15,511,000 to \$16,123,000 for the nine months ended September 30, 2007, respectively, due principally to higher energy costs as compared to the same periods in 2006. Continued levels of increases are expected during the remainder of 2007.

Insurance expense decreased 30.4% and 16.7% in the three and nine months ended September 30, 2007, respectively, as compared to the same periods in 2006 reflecting significant decreases in property insurance resulting primarily from the softer insurance markets.

Telephone reservation center costs decreased slightly from \$2,155,000 and \$6,402,000 in the three and nine months ended September 30, 2006, respectively, to \$1,995,000 and \$6,246,000 in the three and nine months ended September 30, 2007, respectively. We continue to evaluate our telephone reservation center as we evaluate the appropriate staffing levels and location of personnel relative to our expanded portfolio, and as a result, expect telephone reservation center costs to remain somewhat volatile during the remainder of 2007 until we determine our appropriate ongoing level of expenses.

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The following table summarizes selected quarterly financial data with respect to the Same Store Facilities:

|                      | For the Quarter Ended                              |            |              |
|----------------------|--|------------|--------------|
|                      | March 31   | June 30    | September 30 |
|                      | (Amounts in thousands, except for per square foot) |            |              |
| Total rental income: |  |            |              |
| 2007                 | \$ 225,677   | \$ 230,161 | \$ 237,434   |
| 2006                 | \$ 219,297   | \$ 226,352 | \$ 233,420   |



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|   |           |           |           |
|---|-----------|-----------|-----------|
| Total cost of operations (excluding depreciation and amortization): |           |           |           |
| 2007  | \$ 77,828 | \$ 78,234 | \$ 76,060 |
| 2006  | \$ 75,802 | \$ 76,649 | \$ 74,947 |
| Property tax expense:   |           |           |           |
| 2007  | \$ 22,871 | \$ 21,630 | \$ 22,718 |
| 2006  | \$ 21,988 | \$ 20,730 | \$ 21,700 |
| Media advertising expense:  |           |           |           |
| 2007  | \$ 3,365  | \$ 5,333  | \$ 2,885  |
| 2006  | \$ 4,130  | \$ 2,802  | \$ 1,049  |
| REVPAF:   |           |           |           |
| 2007  | \$ 11.09  | \$ 11.32  | \$ 11.66  |
| 2006  | \$ 10.79  | \$ 11.13  | \$ 11.46  |
| Weighted average realized annual rent per occupied square foot:     |           |           |           |
| 2007  | \$ 12.35  | \$ 12.37  | \$ 12.89  |
| 2006  | \$ 11.97  | \$ 12.08  | \$ 12.55  |
| Weighted average occupancy levels for the period:                   |           |           |           |
| 2007  | 89.8%     | 91.5%     | 90.5%     |
| 2006  | 90.1%     | 92.1%     | 91.3%     |

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### ANALYSIS OF REGIONAL TRENDS

The following table sets forth regional trends in our Same Store Facilities:

|  | Three Months Ended    |           | Percentage<br>Change | Nine Mo               |
|--|-----------------------|-----------|----------------------|-----------------------|
|  | September 30,<br>2007 | 2006      |                      | September 30,<br>2007 |
| (Amounts in thousands, except for weighted average)      |                       |           |                      |                       |
| Same Store Facilities Operating Trends by Region         |                       |           |                      |                       |
| Rental income:   |                       |           |                      |                       |
| Southern California (133 facilities)                     | \$ 38,406             | \$ 37,390 | 2.7%                 | \$ 112,680            |
| Northern California (133 facilities)                     | 28,794                | 28,031    | 2.7%                 | 84,092                |
| Texas (156 facilities).....                              | 21,554                | 20,880    | 3.2%                 | 62,309                |
| Florida (141 facilities).....                            | 26,303                | 27,095    | (2.9)%               | 78,597                |
| Illinois (92 facilities).....                            | 17,381                | 16,804    | 3.4%                 | 50,190                |
| Georgia (60 facilities).....                             | 8,231                 | 8,322     | (1.1)%               | 24,248                |
| All other states (601 facilities)                        | 96,765                | 94,898    | 2.0%                 | 281,156               |
| Total rental income.....                                 | 237,434               | 233,420   | 1.7%                 | 693,272               |
| Cost of operations before depreciation and amortization: |                       |           |                      |                       |
| Southern California.....                                 | 8,112                 | 8,002     | 1.4%                 | 24,961                |
| Northern California.....                                 | 7,008                 | 7,041     | (0.5)%               | 21,445                |

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|  |        |        |        |         |
|--|--------|--------|--------|---------|
| Texas.....   | 8,942  | 9,016  | (0.8)% | 27,056  |
| Florida.....   | 9,210  | 8,958  | 2.8%   | 27,186  |
| Illinois.....  | 6,834  | 6,415  | 6.5%   | 21,863  |
| Georgia.....   | 2,734  | 2,646  | 3.3%   | 8,280   |
| All other states.....                                      | 33,220 | 32,869 | 1.1%   | 101,331 |
|  | -----  | -----  | -----  | -----   |
| Total cost of operations.....                              | 76,060 | 74,947 | 1.5%   | 232,122 |
| Net operating income before depreciation and amortization: |        |        |        |         |
| Sou  |        |        |        |         |