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Extra Space Storage, Inc. (EXR) CEO Joseph Margolis on Q3 2019 Results - Earnings Call Transcript

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Q3: 10-29-19 Earnings Summary

Press Release *10-Q* *Slides*

EPS of $0.83 beats by $0.04 | Revenue of $290.92M (9.07% Y/Y) beats by $5.2M

Earning Call Audio

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Extra Space Storage, Inc. (NYSE:EXR) Q3 2019 Earnings Conference Call October 30, 2019 1:00 PM ET

Company Participants

Jeffrey Norman - Vice President of Investor Relations

Joseph Margolis - Chief Executive Officer

Scott Stubbs - Executive Vice President and Chief Financial Officer

Conference Call Participants

Smedes Rose - Citigroup Inc.

Shirley Wu - Bank of America Merrill Lynch

Jeremy Metz - BMO Capital Markets

Stephen Sakwa - Evercore ISI

Todd Thomas - KeyBanc Capital Markets, Inc.

Ki Bin Kim - SunTrust Robinson Humphrey

Ronald Kamdem - Morgan Stanley

Ryan Lumb - Green Street Advisors

Todd Stender - Wells Fargo Securities, LLC,

Michael Bilerman - Citigroup Inc.

Operator

Ladies and gentlemen, thank you for standing by. And welcome to the Third Quarter 2019 Extra Space Storage Incorporated Earnings Conference Call. At this time, all participants' lines are in a listen-only mode. After the speakers' presentation there will be a question-and-answer session. [Operator Instructions] Please be advised that today's conference is being recorded. [Operator Instructions]

I would now like to hand the conference over to your speaker, Mr. Jeff Norman. Please begin, sir.

Jeffrey Norman

Thank you, Norma. Welcome to Extra Space Storage's third quarter 2019 earnings call. In addition to our press release, we have furnished unaudited supplemental financial information on our website.

Please remember that Management's prepared remarks and answers to your questions may contain forward-looking statements as defined in the Private Securities Litigation Reform Act. Actual results could differ materially from those stated or implied by our forward-looking statements due to risks and uncertainties associated with the Company's business. These forward-looking statements are qualified by the cautionary statements contained in the Company's latest filings with the SEC, which we encourage our listeners to review.

Forward-looking statements represent management's estimates as of today, October 30, 2019. The Company assumes no obligation to revise or update any forward-looking statements because of changing market conditions or other circumstances after the date of this conference call.

I'd now like to turn the call over to Joe Margolis, Chief Executive Officer.

Joseph Margolis

Thank you, Jeff. Hello, everyone. Thank you for joining us for our third quarter call and for your interest in Extra Space Storage. We completed another busy and competitive leasing season. The sector headlines coming out of the summer are the same themes we have been hearing for much of the year. Many markets are feeling the headwind of new supply, and digital advertising is as expensive as we have ever seen it.

External growth through traditional acquisitions is challenging due to capital flows into the sector. We also continue to see pressure on multiple expense line items, including property taxes. And despite these headwinds, we had another solid quarter allowing us to increase our annual guidance. As expected, we have started to experience the increased moderation in the second half of the year, which was projected in our guidance.

However, our diversified portfolio, sophisticated platform and strong operations team continue to be resilient. We continued our pricing power with in-place customers and have maintained very strong occupancies at our properties. We also continue to actively explore external growth opportunities that present attractive risk-adjusted returns.

In addition to our acquisitions, we added five new stores to the platform in New York City through a previously announced net lease transaction with W.P. Carey. We also closed several bridge loans and expect to complete over $100 million in total originations in our first year with approximately $45 million of the balances held by Extra Space.

Yesterday, we closed $150 million preferred equity investment with SmartStop with an additional $50 million committed for investment in the next 12 months. The investment has a dividend of 6.25%, which begins to escalate after year five. This investment is senior to a significant amount of common equity and strengthens our ongoing relationship with SmartStop.

Our third-party management platform continues to see exceptional growth. In the quarter, we added 42 managed stores, bringing our year-to-date total to 136. Between our third-party program and our JV stores, we have 877 managed stores, with a strong remaining pipeline for Q4 and for 2020.

I would now like to turn the time over to Scott Stubbs, our CFO.

Scott Stubbs

Thank you, Joe, and hello, everyone. Our Core FFO for the quarter was $1.24 per share, meeting consensus but $0.01 below the high end of our guidance. This was due to delays in completion of several solar projects and the related tax credits, resulting in higher income tax expense. These tax credits will be recognized next year once these projects are completed.

Rental and tenant insurance revenue outperformed expectations. Revenue growth was primarily driven by achieved rate growth with lower discount usage also providing a benefit. Year-over-year occupancy bounced back in Q3 and was flat at quarter end. Like last year, same-store expenses were elevated due to increases in property tax and marketing expense.

We continue to be pleased with the quality of our balance sheet and our access to all types of capital. During the quarter, we accessed our ATM and achieved slightly over $100 million in equity at an average price of $119.30 per share. Year-to-date, we have issued just over $200 million on our ATM. These funds were used for acquisitions and to reduce the balances on our revolving lines.

During the quarter, we also exercised the accordion feature in our credit facility. This transaction provided several benefits: first, it reduced interest cost; second, it converted $500 million in secured debt to unsecured; and third, it extended the average term. Subsequent to quarter end, we completed a $300 million 10-year private placement transaction at the rate of 3.47%, further enhancing our unencumbered property pool.

Due to our property outperformance year-to-date, we have raised our annual same-store guidance to 3% to 3.5%. We revised our expense guidance to an annual range of 4.5% to 5%. These changes result in annual same-store NOI guidance of 2.25% to 3%, a 25 basis point increase at the midpoint. We are also raising our core FFO guidance to $4.84 to $4.87 per share. Our FFO guidance includes $0.07 of dilution from value-add acquisitions and an additional $0.16 of dilution from C of O stores for a total dilution of $0.23, which is unchanged from our initial guidance.

With that, let's turn it over to Norma to start our Q&A.

Question-and-Answer Session

Operator

[Operator Instructions] Our first question comes from Smedes Rose of Citi. Your line is open.

Smedes Rose

Hi. Thanks. I wanted to ask you just really if you could just talk about move-in rates in the quarter versus move-out rates and the gap there and kind of how that's been trending so far in the fourth quarter?

Scott Stubbs

Yes, Smedes. Thanks. At the end of the second quarter, when we looked at how we're performing, we looked at – one of the things that we've focused on was our occupancy, and our occupancy was down about 60 basis points. And while we're always solving for revenue and trying to maximize revenue, we did a couple of things in the quarter to bring that occupancy back to flat.

And so during the quarter, we decreased rates and we increased our occupancy. So we went from being down 60 basis points to being flat at the end of the quarter. And then today, we're actually 10 basis points ahead in October. So lowering rates obviously helps. Now when I talk about lowering rates, I'm saying our achieved rate was actually lower during the third quarter. At the end of the quarter and where we are today is our achieved rates are actually slightly negative year-over-year. Our achieved rates are slightly negative to the tune of low single-digits.

Smedes Rose

Okay. And then are you thinking about any changes, I guess, in your pricing strategies going forward in order to retain higher-paying in-place customers? Or any thoughts around that?

Scott Stubbs

Yes. No significant changes in our pricing strategy. One thing that will happen in the fourth quarter is we do lose the benefit of our discounts. And so what I mean by that is discounts have provided about a 40 basis point tailwind for us for the year. And in the fourth quarter, we really lap when we change that strategy. And so the fourth quarter is comparable year-over-year.

Smedes Rose

Okay. Thanks. And then Joe, could you just talk about the SmartStop investment? You bought the portfolio from them before. Is this investment a lead up to similar transaction? Or is it just an attractive return?

Joseph Margolis

Hopefully, both. I mean we've had a good and long relationship with SmartStop. As you pointed out, we bought large portfolio from them in 2015. In connection with that transaction, we made a loan to them, which they fully paid back and without default. We managed almost 100 stores for them until they internalized management. So we know this company and these properties very, very well. This was a good investment for us, accretive investment. We're in a very comfortable position from a risk standpoint. And we also feel it strengthens our relationship with the company and hopefully we'll do more with them in the future.

Smedes Rose

Okay. Thank you.

Joseph Margolis

Thanks, Smedes.

Operator

Thank you. And our next question comes from Shirley Wu of Bank of America.

Shirley Wu

Thanks for taking the question. So my first question has to do with guidance. You've raised both revenue and NOI, but the midpoint of guidance still implies a drastic sequential deceleration in revenues to 1.6 in 4Q and negative NOI for 4Q. So I was wondering if you could provide some more color on the cadence for the remainder of the year. And what does it take to get the high or low end of this guidance ranges?

Scott Stubbs

Yes. So if you look at how we performed year-to-date and then how we're performing into October, you're correct, it would take a pretty significant decrease in the fourth quarter to hit the low end of guidance, and we do not feel like that's likely. If you look at our cadence into the fourth quarter, our guidance does assume some continued moderation as well as that loss of a discount benefit of 40 basis points.

Shirley Wu

Okay. Thanks for the color. And my second question, it goes to marketing. So 3Q is up around almost 44%, so could you give us some thoughts on your strategy moving forward as you reflect on what you've seen this year and the effectiveness of the marketing strategy and your thoughts about using marketing into 2020 as well?

Joseph Margolis

Sure. So I think the first thing to make sure we all understand is the marketing dollars we spend have a very good ROI on them that we are spending more money in marketing. We wish we didn't have to, but it is leading to more folks in the stores paying rent, and we get a good return on our marketing dollars.

We expect marketing expense to remain elevated. And our job is to make sure we are as smart as we can possibly be with our marketing dollars in terms of bidding on the right terms, in the right places, at the right time and also finding alternatives to Google to drive business to our stores.

Shirley Wu

Got it. Thanks, Joe.

Joseph Margolis

You're welcome.

Operator

Thank you. And our next question comes from the line of Jeremy Metz with BMO Capital Markets. Your line is open.

Jeremy Metz

Hey, guys. Just trying to connect the dots here, Joe, between your comments in the opening about acquisitions being more challenging due to capital flows in the sector. This is something we've been hearing about for a while. And you've still managed to find your share of deals over time, a lot of that came through the third-party platform.

So wondering if that's dried up a little here and therefore – even if temporarily and therefore, maybe a SmartStop deal a little more compelling, which, from a return perspective, it's fine at the 6.25%, but when we just compare that to where you've been able to buy and stabilize that and even the same with your C of O deals that has generally been higher, so any color on that?

Joseph Margolis

Yes. Thanks for the opportunity to clarify. First to your last point, I think relative return always goes with relative risk. So yes, this is a 6.25% dividend payment, but it is ahead of hundreds of millions of dollars, significant amount of common equity. So the return may not be as good as doing a C of O deal, but the risk is significantly less.

And in this point in the market cycle, we are very focused on risk. So my comments on the introduction about capital flows and difficulty finding deals really focuses on traditional marketed deals. Once the deal gets out to the market and broker has it, and there's many, many bidders, I think it's very difficult for us to be that high bidder and capture that deal.

That being said, we've been very active on the acquisition side. Through the end of the third quarter, we purchased $362 million. We've invested $362 million in acquisitions. We have another $52 million – $50 million, $52 million under contract to close this year. We hope to find a couple other deals.

In addition, we'll do a little over $100 million in our bridge loan program. We did the net lease deal, which has no capital outplay, but a good return. So while we haven't been able to purchase a lot in the market by having good relationships, buying things from our JV partners or management plus finding creative deals, we've been able to have, what I think is, a good year on the growth front.

Jeremy Metz

Yes. And sticking just with the growth angle here, can you talk about the environment today for the – for C of O deals? You've previously mentioned a void you've seen in funding some lease-up deal, that's why you started the bridge loan program. But you're still seeing a lot of presale-type opportunities or even conversely opportunities to outright purchases of lease-up deals that aren't hitting underwriting or developers wanting to get out?

Joseph Margolis

So we see few C of O opportunities. Part of that is the moderation in development and part of that is our view of the acceptable return level to take that risk of our lease-up store in this environment. That being said, we have – our committee so far has approved five new deals – new C of O deals in 2019, one in Hawaii and a package of four, we'll do a joint venture in Minneapolis – in and around Minneapolis.

On the lease-up side, there are those opportunities coming up of partially leased stores being brought to the market. And I believe sellers' expectations versus, I'll say, Extra Space's pricing, there's still some gap there in many instances. But we look at a lot of them and we underwrite a lot of them and we'll participate when we think the pricing is right.

Jeremy Metz

Great. Thanks guys.

Joseph Margolis

Thanks, Jeremy.

Operator

Thank you. And our next question comes from Steve Sakwa of Evercore ISI. Your line is open.

Stephen Sakwa

Thanks. I guess the question is really around sort of the decel that you've seen throughout the year and the implied revenue guide was somewhere maybe in kind of the mid- to upper-1s to maybe the low-2s for Q4 which is down from little over 4% in the first quarter. And I'm just, if you think about kind of the exit velocity of 2019 and fourth quarter going into 2020? How do we think about that sort of 2-ish kind of revenue number as it relates to maybe growth all of next year?

Scott Stubbs

So I would tell you, we are in the process of doing our budgets and we're probably not ready to give 2020 guidance. But I think that you have seen deceleration throughout the year, starting the year closer to 4% and then ending this quarter closer to 3% and then some implied deceleration in the fourth quarter. So I think that as we roll up the budgets and take a look at where we are with the supply because I think a portion of the supply that's projected for 2019 will actually push into 2020. And so until we kind of have some of those moving pieces stop moving, it's really difficult to give that number without knowing that. And so look for that in the February call.

Stephen Sakwa

Okay. And I can appreciate that. And just – is there anything in the 2019 numbers, whether it was a same-store pool shift or just kind of any one-time items that may have kind of elevated the 2019 number versus 2020 putting kind of fundamentals aside?

Joseph Margolis

Yes. The effect of the same-store shift is pretty modest. It's depending on how you – if you're looking at the prior year – or the two prior years, it's 10 to 30 basis points. So that really doesn't have a big effect on the numbers.

Scott Stubbs

Yes. I think in the quarter, it was about 10 basis points, Steve. And then if you look on the expense side, we expect property taxes to still be elevated, but hopefully less elevated. We expect them to be above inflation, but we budgeted 5% to 6% for the last couple of years. We're hoping that number is down. We haven't finalized our budget yet, but we're hoping it's more in the 3% to 4% range.

Stephen Sakwa

Okay. And then, I guess, Joe, you made the comment about the Google marketing and trying to find other ways, given just how expensive that channel has become. I'm just curious, what are some of those other options? I mean, have you used them in the past? And how effective were those versus kind of the Google click paid advertising?

Joseph Margolis

So social media is very small now about growing pretty quickly. So that's an interesting avenue that we and others are trying. We actually, in the last quarter, went back to some hard billboards and doing some things like that. So we are trying other avenues, and I think it's way too early to say how effective they will be and what will be the winners and what may not be the winners.

Stephen Sakwa

Okay. And that’s it for me. Thanks.

Joseph Margolis

Thank you.

Scott Stubbs

Thank you.

Operator

Thank you. And our next question comes from Todd Thomas of KeyBanc Capital Markets. Your line is open.

Todd Thomas

Hi. Thanks. First question, in terms of the price adjustments that you made late last quarter to support the recovery in occupancy. You operate nearly 1,800 stores. And I'm just curious if you saw bigger swings or more volatile pricing from competitors at that time as they look to gain ground and drive customer traffic when you made those changes across the platform?

Scott Stubbs

I'm not sure it's specific to the quarter. I think we've seen people adjusting prices throughout the year and, obviously, very aggressive in markets with new supply.

Todd Thomas

Okay. In terms of discounting, it seems a little bit more less pronounced today than I think we've seen in sort of prior cycles. And you mentioned, it was lower year-over-year. In the quarter, it might smooth out a little bit going forward. But we've heard from others that discounting is down also. Can you explain why discounting appears to be sort of less effective today? Or is that not really the right way to think about it necessarily?

Scott Stubbs

I think it’s probably not the correct way to think about it. We're typically looking at different strategies and testing. And right now, we have found the marketing spend and then adjusting pricing slightly to be more effective than discounting. Last year, we were more aggressive with discounting, this year less aggressive. And last year, we held rate a little bit better. This year, we've had give a little bit on rent.

Todd Thomas

Okay. So the response overall from discounting, though, it's still there. If you increase discounting, you still feel that you can increase customer traffic to the system?

Scott Stubbs

It's still an effective tool, but we've found some of the others to be more effective this year.

Todd Thomas

Okay. And then just last question on the bridge loan program. I was just wondering if you can provide a little bit more detail on the outlook for that book heading into 2020? I think you said $100 million is sort of the volume that you're going to do this year. Would you expect to see that grow in 2020? And sort of what kind of rates are you getting? And how large of an investment? And would you be willing to do with – on the bridge program?

Joseph Margolis

So I would expect the bridge loan program to grow significantly, I would say, at least double in 2020. Rates we get range from plus or minus LIBOR plus 400. So when we started, we thought they'd all be empty stores coming right on C/Os and it turns out we found lots of other situations folks wanted with partially leased stores. So some of those rates are lower. And then I think our highest rates so far has been LIBOR plus 440. So plus or minus LIBOR plus 400. The return to us depends on whether we use our debt partner to take the a piece, if you will, in which case we can be up to LIBOR plus 800, 900 on our piece.

And I think the last question was how much will – we will do that. I think that's meant to be seen. The type of volume we're talking about right now is very comfortable for us given our different avenues of capital. But one of the reasons we arranged this program with a debt partner was not only to enhance our returns, but to be able to control how much capital we had in the program. So we have that tools to make sure we're in a comfortable place.

Todd Thomas

Okay. All right. Thank you.

Scott Stubbs

Thanks Todd.

Operator

Thank you. And our next question comes from Ki Bin Kim with SunTrust. Your line is open.

Ki Bin Kim

Good afternoon. So obviously, expenses are a little bit elevated right now. It shouldn't be a big surprise. But as we lap the higher expenses, comps get easier, mathematically. But should we expect continued inflation in expenses, I'm talking about marketing and also things like property taxes as we get into next year?

Scott Stubbs

Yes, Ki Bin, I would expect property taxes to be above inflation. Hopefully, they come off where they've been in the last couple of years. Marketing, I would expect to be above inflation. And then I think that we will see some pressure on wages, and part of that is because we have such a hard comp from this year, our wages have been very low year-over-year this year, but we don't expect that – us to be able to maintain that.

Ki Bin Kim

Ki Bin Kim

Okay. And I don't want to spend too much time on the SmartStop deal, but the safetyness comment you made, Joe, it also does rely on the common equity being in the money. So I don't know the SmartStop portfolio in and out, but given the vintage of it, do you feel pretty comfortable that the common equity that you're ahead of is actually in the money to a deep degree?

Joseph Margolis

So we do know the SmartStop portfolio in and out. We managed almost all of these stores for a long period of time before they internalized management. And we also know the company very well and have a lot of comfort, both from our knowledge of them and also from restriction, kind of typical market restrictions in the documents of what they're allowed to do as a company and not allowed to do. So we feel very, very comfortable with this transaction from a risk standpoint.

Ki Bin Kim

Okay, thanks. And just last question, what type of IRRs do you – are you targeting for acquisitions?

Joseph Margolis

So, we certainly run IRRs and look at IRRs, but it's really not the focus of what we do, right, because of how we underwrite, because to create an IRR, you have to have a whole period and a terminal cap rate. And we generally hold things for a very, very long time. And I can't guess what cap rates are going to be in seven years or 10 years or 15 years. So we look much more at cash flows over a seven-year period and what the average cash flows will be and focus much more on that.

Ki Bin Kim

Okay, thank you.

Joseph Margolis

Thanks Ki Bin.

Operator

[Operator Instructions] And our next question comes from Ronald Kamdem of Morgan Stanley. Your line is open.

Ronald Kamdem

Hey, thanks for taking the question. Just back to the marketing spend. Just a few – is there any more color in terms of how much is the rise basically actually just cost per clicks increasing versus just more usage of the marketing? And is there any broad regions or areas or market where it's maybe even more elevated than the average?

Scott Stubbs

Yes. It's fairly difficult to break down that way. We would tell you, it primarily relates to the inflationary aspect of it and us being more aggressive on our bids and less to do with the additional clicks or the additional rentals from that.

Ronald Kamdem

Got it, helpful. And then the last one was just on – I think there's a lot of talks about technology and upgrading the platform. Is there any low-hanging fruits left on the payroll side? So obviously, you've done a great job of keeping that pretty tight this year, but is there even further opportunities to sort of automate and sort of continue to reduce that line item?

Joseph Margolis

So a couple of things. I think there are always things we can do to improve, to centralize to get more efficient, to have technology perform some jobs. But that being said, I think the wage pressure we're seeing in this country with the low unemployment is going to override that at least in the short term, at least next year.

And also, we put a high value on our people, and whether it's the data scientists here in Salt Lake City or the folks in the store who are face-to-face with the customer everyday. And we are a business that has very high operating margins. So the incremental cost of having a very high quality employee in front of the customers versus losing one or two rentals a month, it's to us that's an easy equation.

And we want to make sure we have good and high-quality people in our stores. And if that means we're going to see some pressure on the wage side then that's a trade we're willing to make.

Ronald Kamdem

Got it. And then the last question was – I don't know if you provide any updated thoughts on just your supply outlook, maybe nothing has changed there, but just curious how you guys are thinking about it now? Thank you.

Joseph Margolis

Sure. We don't have a lot of new thoughts on supply. We continue to believe that 2020 there'll be some moderation from 2019, but not wholesale falling off the cliff. We'll see some markets that will be in worse positions and we'll see some markets that will be in better positions as they lease up. And of course, with our broadly diversified portfolio, also have exposure to a lot of markets that have never been in the supply headwind situation. So we will continue to have pressures on the supply in 2020, but we're happy to believe and see deliveries starting to moderate.

Ronald Kamdem

Helpful. Thanks so much.

Joseph Margolis

Sure. Thank you.

Scott Stubbs

Thanks.

Operator

Thank you. And our next question comes from Ryan Lumb of Green Street Advisors. Your line is open.

Ryan Lumb

Thanks. Going back to the preferred deal, are there multiple other opportunities on the horizon that are similar to this? And is this going to become sort of a pillar of the capital or asset-light model? Or is this sort of a one-off deal, which is based on the relationship that you guys have with SmartStop?

Joseph Margolis

I would say more of the latter than the former. Similar to the net lease deal, a company we had a relationship with had a specific need in the situation, and we were able to put that hole and fill it. We're not out seeking to start a preferred equity shop. But if another opportunity arose that had similar risk-reward characteristics and provided a good return to us, we will certainly look at it.

Ryan Lumb

Sure. And then last quarter, Joe, I think you said that you don't see any moderation in demand anywhere. Can you just say – is that still your view today? Or – and if there's any sort of market level color on demand, what direction demand is going broadly?

Joseph Margolis

That is still our view today is that demand is very steady and very strong. And all of our challenges are due to supply and not demand.

Ryan Lumb

Sure. That’s all for me. Thanks guys.

Joseph Margolis

Thanks, Ryan.

Operator

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Thank you. And our next question comes from Todd Stender of Wells Fargo. Your line is open.

Todd Stender

Hi. Thanks. Just on the acquisition front. You didn’t buy any stabilize stores in your wholly-owned portfolio, but you've been remained active in joint ventures. Can we just here some of the underwriting metrics, like maybe growth expectations, in-place occupancy and how they are, I guess, adequate for you to invest in, in the joint venture, but not wholly owned?

Joseph Margolis

So underwriting metrics verify market, we would underwrite stronger rent growth in Los Angeles than in Dallas, for example. So I can’t give you – we don’t have a menu that we pick all of our assumptions off that's creating on a deal-by-deal basis based on the specific submarket opportunity. And we're lucky to have 1,800 stores and have a lot of data about what goes on in these markets. So we feel we can underwrite very accurately. With respect to why do something in a joint venture versus wholly-owned, joint ventures do a number of things for us.

One is they spread risk, and if we have smaller dollar investment in a particular asset. Secondly, it enhances returns in a couple ways. One is we get all the tenant insurance on a smaller investment base than 100% owned. We get a management fee and many of them we get the opportunity to earn or promote down the road. So our return levels are higher in a joint venture.

Todd Stender

Thank you. It were these on a slower growth expectation range? I know there's a little more leverage you can add and I appreciate your comments there about how you distinguish, but how about these, in particular or maybe a little more lease up?

Joseph Margolis

So when you say these it puts…

Todd Stender

Todd Stender

Not the three, sorry. Yes, the three that you acquired in the quarter, just distinguishing why are these went into a joint venture, maybe the slower growth expectations. Any little context you can provide might help?

Joseph Margolis

So these were three assets in Albuquerque, New Mexico that on a wholly-owned basis we didn't feel provided a risk-reward metric that we are comfortable for our shareholders.

Todd Stender

Got it. Okay. That's helpful. And then just going back to the guidance, just two categories that I think amongst others differentiate you guys from your peers is tenant insurance income and then the management fees. They both increased. Just as a reminder, can we hear anything that you can provide based on margins? How you're achieving these kind of growth for both? Any context you can provide around both? Thanks.

Scott Stubbs

Yes. So our management fee business has grown primarily just by adding properties and a large portion of those properties are lease-up assets. So as their revenues go up, our management fee also goes up. Many of them when they come on at day one are just earning the minimum management fee. And so as they start to get more occupied, we, obviously, make more money.

In terms of tenant insurance business, as we add properties, we add tenant insurance. We also have the ability to increase penetration. Many of our lease-up stores have higher penetrations just because you have the opportunity to offer tenant insurance from day one versus we typically don't go back and try to increase our penetration with the existing customers.

Todd Stender

And the lease-ups got for that, that's a higher penetration, 7 to 8 out of 10 tenants get it. Is that fair?

Scott Stubbs

Scott Stubbs

I would tell you it's a little higher than that. Your overall penetration is just north of 70. And on lease-up stores, it's typically higher than that.

Todd Stender

Okay. Thank you.

Scott Stubbs

Thanks Todd.

Operator

Thank you. And we have a follow-up with Smedes Rose with Citigroup. Your line is open.

Michael Bilerman

Hey. It's Michael Bilerman here with Smedes. I was wondering if you can talk a little bit about the competitive environment relative to PSA, in a sense of their bigger focus over the last, let's call it, 12 to 18 months on two fronts. One is on the CapEx front and improving their front door and really investing in the property of tomorrow, their fifth generation?

And the second is a really big focus on the asset management and the second being a focus if they hadn't done before on the third-party management business. And I'm just wondering how you've seen any impact from those two relative to the markets that you compete in?

Joseph Margolis

So much more comfortable talking about what we're doing than what Public Storage is doing. We started a seven-year rebranding program to rebrand all of our stores, and we're through four years in that and the vast majority of our REIT stores have now been rebranded less of our JV and managed stores. But we've been putting that type of capital into our properties for a number of years now. And we think we have benefited in terms of performance from those capital investments.

And in terms of the management business, Public Storage is a good manager. They know how to run properties. CubeSmart is a good manager. They know how to run properties. We have good competitors on that side. We don't get every piece of business, but we hold our pricing which is more expensive than our competitors because we want to remain a profitable business and we've been able to keep growing this business.

We've added 136 stores gross through the end of the third quarter. We've lost 43 stores, but 25 of those 43, we purchased store or became net leases, so they just shifted on the platform. So two quarters, we've added 93 stores. And our pipeline looks very similar going forward. And so while we have good competitors in that business, we're still able to win at least our share of the business.

Michael Bilerman

Right. And I'm not trying to say anything that is wrong for what we're doing. It's just when others in the marketplace do something, right, you can't control the amount of supply. You can control what you build, but you can't control what other people build. And you can't control what competitors. And if you have a competitor that has decided to change the way they're operating, right, and invest a lot of capital in their assets, one would imagine that could have an impact on the entire marketplace and affect all competitors, including yourselves, right. So that's where I was really trying to understand whether any part of this year's performance, you feel has had some impact from the competitive set? And maybe it's not PSA specific, but the market getting better in that sense. It's a tougher environment well for you to compete in?

Joseph Margolis

What I think that's a fair comment. I think it is a tougher environment to compete in, and our competitors don't sit still and they decide to put capital into their buildings or decide to get into the management business or improve their pricing systems or whatever they're doing. And we fully understand that it's not a static environment. And that why we need to get better in everything we do.

We need to continue to invest in technology, and we need to continue to refine our pricing systems or our keyword bidding systems. We need to do more data analytics, more testing. And we do that all the time and we don't maybe talk about it enough. But if our competitors are running to catch up, we need to run just as fast as to stay ahead.

Michael Bilerman

Right, it's not faster, which you've done in the past. Back in January, we were sitting in Salt Lake. You spent a lot of time on Optimus Prime and leveraging Google and being able to really target individual search words to really reduce pricing. You talked a little bit about how Google has gotten more expensive. Has your systems not been able to figure out a way to start to cut into some of that increase at all?

Joseph Margolis

I believe they have. I believe our systems are very good at spending money where it has an impact and not bidding on terms if that's the system you're talking about where there's not a very strong return. It doesn't look like it because the increase has been so much but we have been very careful to make sure we're spending money where it has a positive impact. And I think the bottom line trying to proof in the pudding is the results we're putting up.

Michael Bilerman

Yes. Last one just on [valley], you had the UPS announced their initiatives, and I think it was Atlanta and the test market. During the quarter, you obviously have had a mix space partner up with Iron Mountain. Has there been any impact that you see changing in the marketplace from those sorts of initiatives?

Joseph Margolis

We just haven't felt the impact. We look at our small units in urban markets where those valley companies are operating, look at the occupancy and the rents and I don't know if they're getting a customer that that isn't a traditional storage customer or if we're able to maintain our performance in spite of them nibbling at the edges, but we just haven't felt it yet.

yet.

Michael Bilerman

Okay. Thanks for the time, Joe.

Joseph Margolis

Thanks, Michael.

Scott Stubbs

Appreciate it, Michael.

Operator

And I'm currently showing no further questions. I'd like to turn the call back over to Mr. Joe Margolis for closing comments.

Joseph Margolis

Great. Thank you everyone for joining us today. We're 10 months into the year now, and what is really gratifying to me is I look back, is how the year has played out as we expected. We went into this year knowing we would face headwinds from new supply and then we would have to be nimble and creative to address the challenges in those particular markets.

We went into the year knowing that traditional acquisitions would be difficult due to capital flows into the sector and we would have to be innovative to create a creative growth opportunities. And I think we've done that and we went into the year knowing that expecting to have continued growth in our third-party management business. And as we just talked about, we've had a great year in that front.

The two surprises we've had this year is the higher marketing expenses. And we've had to deal with that and maintain performance in spite of those increased costs. And the second surprise has been that the moderation in revenue growth is taking longer to occur. And that's benefited us and allowed us to increase our guidance.

So looking back over the 10 months, I'm very happy and proud that our systems and teams is handled the environment that the machine is worked, and then we've been able to put up the performance that we have so far, and we expect to for the remainder of the year. Thank you very much for your interest in Extra Space. I hope everyone has a great rest of their days.

Operator

Ladies and gentlemen, this concludes today conference. Thank you for your participation. You may now disconnect.