

ESSEX PROPERTY TRUST INC

Form 10-Q

November 04, 2015

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

ý QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2015

OR

o 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 001-13106

ESSEX PROPERTY TRUST, INC.

ESSEX PORTFOLIO, L.P.

(Exact name of Registrant as Specified in its Charter)

Maryland (Essex Property Trust, Inc.)

77-0369576 (Essex Property Trust, Inc.)

California (Essex Portfolio, L.P.)

77-0369575 (Essex Portfolio, L.P.)

(State or Other Jurisdiction of Incorporation or Organization)

(I.R.S. Employer Identification Number)

925 East Meadow Drive

Palo Alto, California 94303

(Address of Principal Executive Offices including Zip Code)

(650) 494-3700

(Registrant's Telephone Number, Including Area Code)

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 reports), and (2) has been subject to such filing requirements for the past 90 days.

Essex Property Trust, Inc. Yes  No

Essex Portfolio, L.P. Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

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Essex Property Trust, Inc. Yes  No

Essex Portfolio, L.P. Yes  No

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

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Essex Property Trust, Inc.:

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

Essex Portfolio, L.P.:

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

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

Essex Property Trust, Inc. Yes  No

Essex Portfolio, L.P. Yes  No

**APPLICABLE ONLY TO CORPORATE ISSUERS:**

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: 66,035,140 shares of Common Stock (\$0.0001 par value) of Essex Property Trust, Inc. were outstanding as of October 30, 2015.

## EXPLANATORY NOTE

This report combines the reports on Form 10-Q for the three and nine month periods ended September 30, 2015 of Essex Property Trust, Inc. and Essex Portfolio, L.P. Unless stated otherwise or the context otherwise requires, references to “Essex” mean Essex Property Trust, Inc., a Maryland corporation that operates as a self-administered and self-managed real estate investment trust (“REIT”), and references to “EPLP” mean Essex Portfolio, L.P. (the “Operating Partnership”). References to the “Company,” “we,” “us” or “our” mean collectively Essex, EPLP and those entities/subsidiaries owned or controlled by Essex and/or EPLP. References to the “Operating Partnership” mean collectively EPLP and those entities/subsidiaries owned or controlled by EPLP.

Essex is the general partner of EPLP and as the sole general partner of EPLP, Essex has exclusive control of EPLP's day-to-day management.

The Company is structured as an umbrella partnership REIT (“UPREIT”) and Essex contributes all net proceeds from its various equity offerings to the Operating Partnership. In return for those contributions, Essex receives a number of OP Units (see definition below) in the Operating Partnership equal to the number of shares of common stock it has issued in the equity offering. Contributions of properties to the Company can be structured as tax-deferred transactions through the issuance of OP Units in the Operating Partnership, which is one of the reasons why the Company is structured in the manner outlined above. Based on the terms of EPLP's partnership agreement, OP Units can be exchanged with Essex common stock on a one-for-one basis. The Company maintains a one-for-one relationship between the OP Units of the Operating Partnership issued to Essex and shares of common stock.

The Company believes that combining the reports on Form 10-Q of Essex and EPLP into this single report provides the following benefits:

- enhances investors' understanding of the Company and the Operating Partnership by enabling investors to view the business as a whole in the same manner as management views and operates the business;
- eliminates duplicative disclosure and provides a more streamlined and readable presentation since a substantial portion of the disclosure applies to both the Company and the Operating Partnership; and
- creates time and cost efficiencies through the preparation of one combined report instead of two separate reports

Management operates the Company and the Operating Partnership as one business. The management of Essex consists of the same members as the management of EPLP.

All of the Company's property ownership, development and related business operations are conducted through the Operating Partnership and Essex has no material assets, other than its investment in EPLP. Essex's primary function is acting as the general partner of EPLP. As general partner with control of the Operating Partnership, the Company consolidates the Operating Partnership for financial reporting purposes. Therefore, the assets and liabilities of the Company and the Operating Partnership are the same on their respective financial statements. Essex also issues equity from time to time and guarantees certain debt of EPLP, as disclosed in this report. The Operating Partnership holds substantially all of the assets of the Company, including the Company's ownership interests in its joint ventures. The Operating Partnership conducts the operations of the business and is structured as a partnership with no publicly traded equity. Except for the net proceeds from equity offerings by the Company, which are contributed to the capital of the Operating Partnership in exchange for additional limited partnership interests in the Operating Partnership (“OP Units”) (on a one-for-one share of common stock per OP Unit basis), the Operating Partnership generates all remaining capital required by the Company's business. These sources include the Operating Partnership's working capital, net cash provided by operating activities, borrowings under its revolving credit facilities, the issuance of secured and unsecured debt and equity securities and proceeds received from disposition of certain properties and joint ventures.

The Company believes it is important to understand the few differences between Essex and EPLP in the context of how Essex and EPLP operate as a consolidated company. Stockholders' equity, partners' capital and noncontrolling interest are the main areas of difference between the consolidated financial statements of the Company and those of the Operating Partnership. The limited partners of the Operating Partnership are accounted for as partners' capital in the Operating Partnership's consolidated financial statements and as noncontrolling interest in Essex's consolidated financial statements. The noncontrolling interest in the Operating Partnership's consolidated financial statements include the interest of unaffiliated partners in various consolidated partnerships and joint venture partners. The noncontrolling interest in the Company's consolidated financial statements include (i) the same noncontrolling interest as presented in the Operating Partnership's consolidated financial statements and (ii) limited partner OP Unitholders of the Operating Partnership. The differences between stockholders' equity and partners' capital result from differences in the equity issued at the Company and Operating Partnership levels.

To help investors understand the significant differences between the Company and the Operating Partnership, this report provides separate consolidated financial statements for the Company and the Operating Partnership; a single set of consolidated notes to such financial statements that includes separate discussions of stockholders' equity or partners' capital, and earnings per share/unit, as applicable; and a combined Management's Discussion and Analysis of Financial Condition and Results of Operations.

This report also includes separate Part I, Item 4. Controls and Procedures sections and separate Exhibits 31 and 32 certifications for each of the Company and the Operating Partnership in order to establish that the requisite certifications have been made and that the Company and the Operating Partnership are compliant with Rule 13a-15 or Rule 15d-15 of the Securities Exchange Act of 1934 and 18 U.S.C. §1350.

In order to highlight the differences between the Company and the Operating Partnership, the separate sections in this report for the Company and the Operating Partnership specifically refer to the Company and the Operating Partnership. In the sections that combine disclosure of the Company and the Operating Partnership, this report refers to actions or holdings as being actions or holdings of the Company. Although the Operating Partnership is generally the entity that directly or indirectly enters into contracts and joint ventures and holds assets and debt, reference to the Company is appropriate because the Company is one business and the Company operates that business through the Operating Partnership. The separate discussions of the Company and the Operating Partnership in this report should be read in conjunction with each other to understand the results of the Company on a consolidated basis and how management operates the Company.

The information furnished in the accompanying unaudited condensed consolidated balance sheets, statements of income and comprehensive income, equity, capital, and cash flows of the Company and the Operating Partnership reflect all adjustments which are, in the opinion of management, necessary for a fair presentation of the aforementioned condensed consolidated financial statements for the interim periods and are normal and recurring in nature, except as otherwise noted.

The accompanying unaudited condensed consolidated financial statements should be read in conjunction with the notes to such unaudited condensed consolidated financial statements and Management's Discussion and Analysis of Financial Condition and Results of Operations herein. Additionally, these unaudited condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements included in the Company's annual report on Form 10-K for the year ended December 31, 2014.

ESSEX PROPERTY TRUST, INC.  
 ESSEX PORTFOLIO, L.P.  
 FORM 10-Q  
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## Part I – Financial Information

## Item 1. Condensed Financial Statements

## ESSEX PROPERTY TRUST, INC. AND SUBSIDIARIES

## Condensed Consolidated Balance Sheets

(Unaudited)

(In thousands, except share amounts)

ASSETS	September 30, 2015	December 31, 2014
Real estate:		
Rental properties:		
Land and land improvements	\$2,566,586	\$2,424,930
Buildings and improvements	9,753,982	8,819,751
	12,320,568	11,244,681
Less accumulated depreciation	(1,858,134 )	(1,564,806 )
	10,462,434	9,679,875
Real estate under development	226,690	429,096
Co-investments	1,036,043	1,042,423
Real estate held for sale, net	8,742	56,300
	11,733,909	11,207,694
Cash and cash equivalents-unrestricted	35,668	25,610
Cash and cash equivalents-restricted	36,638	70,139
Marketable securities and other investments	133,058	117,240
Notes and other receivables	22,668	24,923
Acquired in place lease value, net	12,675	47,748
Prepaid expenses and other assets	38,101	33,378
Total assets	\$12,012,717	\$11,526,732
<b>LIABILITIES AND EQUITY</b>		
Unsecured debt, net	\$3,090,896	\$2,603,548
Mortgage notes payable, net	2,224,513	2,234,317
Lines of credit, net	2,011	242,824
Accounts payable and accrued liabilities	177,807	135,162
Construction payable	26,411	30,892
Dividends payable	99,945	88,221
Other liabilities	34,722	32,444
Total liabilities	5,656,305	5,367,408
Commitments and contingencies		
Redeemable noncontrolling interest	24,589	23,256
Equity:		
Common stock; \$0.0001 par value, 656,020,000 shares authorized; 65,234,597 and 63,682,646 shares issued and outstanding, respectively	6	6
Cumulative redeemable 7.125% Series H preferred stock at liquidation value	73,750	73,750
Additional paid-in capital	6,980,443	6,651,165
Distributions in excess of accumulated earnings	(782,801 )	(650,797 )
Accumulated other comprehensive loss, net	(50,357 )	(51,452 )
Total stockholders' equity	6,221,041	6,022,672
Noncontrolling interest	110,782	113,396
Total equity	6,331,823	6,136,068

Total liabilities and equity	\$12,012,717	\$11,526,732
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See accompanying notes to the unaudited condensed consolidated financial statements.

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ESSEX PROPERTY TRUST, INC. AND SUBSIDIARIES  
Condensed Consolidated Statements of Income and Comprehensive Income  
(Unaudited)  
(In thousands, except share and per share amounts)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
Revenues:				
Rental and other property	\$302,522	\$268,512	\$876,852	\$684,813
Management and other fees from affiliates	2,104	2,361	6,809	6,856
	304,626	270,873	883,661	691,669
Expenses:				
Property operating, excluding real estate taxes	60,528	56,294	173,547	146,474
Real estate taxes	33,591	31,768	97,820	77,452
Depreciation and amortization	116,308	102,286	336,946	253,890
General and administrative	11,129	11,479	31,223	28,621
Merger and integration expenses	—	3,857	3,798	46,413
Acquisition and investment related costs	381	51	1,357	768
	221,937	205,735	644,691	553,618
Earnings from operations	82,689	65,138	238,970	138,051
Interest expense	(50,053)	(45,830)	(148,401)	(117,021)
Interest and other income	7,367	2,992	14,820	8,685
Equity income in co-investments	7,179	4,910	15,962	21,065
Gains on sale of real estate and land	—	31,372	7,112	38,853
Gain on remeasurement of co-investment	—	—	34,014	—
Net income	47,182	58,582	162,477	89,633
Net income attributable to noncontrolling interest	(3,545)	(3,720)	(11,295)	(8,971)
Net income attributable to controlling interest	43,637	54,862	151,182	80,662
Dividends to preferred stockholders	(1,314)	(1,296)	(3,941)	(3,977)
Net income available to common stockholders	\$42,323	\$53,566	\$147,241	\$76,685
Comprehensive income	\$46,970	\$61,036	\$163,609	\$99,070
Comprehensive income attributable to noncontrolling interest	(3,538)	(3,789)	(11,332)	(9,345)
Comprehensive income attributable to controlling interest	\$43,432	\$57,247	\$152,277	\$89,725
Per share data:				
Basic:				
Net income available to common stockholders	\$0.65	\$0.85	\$2.28	\$1.41
Weighted average number of shares outstanding during the period	65,138,868	62,892,601	64,714,994	54,250,104
Diluted:				
Net income available to common stockholders	\$0.65	\$0.85	\$2.27	\$1.41
Weighted average number of shares outstanding during the period	65,297,550	63,069,772	64,892,770	54,443,227
Dividend per common share	\$1.44	\$1.30	\$4.32	\$3.81

See accompanying notes to the unaudited condensed consolidated financial statements.

## ESSEX PROPERTY TRUST, INC. AND SUBSIDIARIES

Condensed Consolidated Statement of Equity for the nine months ended September 30, 2015

(Unaudited)

(Dollars and shares in thousands)

	Series H Preferred stock		Common stock		Additional paid-in capital	Distributions in excess of accumulated earnings	Accumulated other comprehensive loss, net	Noncontrolling	
	Shares	Amount	Shares	Amount				Interest	Total
Balances at December 31, 2014	2,950	\$73,750	63,683	\$6	\$6,651,165	\$(650,797)	\$(51,452)	\$113,396	\$6,136,068
Net income	—	—	—	—	—	151,182	—	11,295	162,477
Change in fair value of derivatives and amortization of swap settlements	—	—	—	—	—	—	1,621	54	1,675
Change in fair value of marketable securities	—	—	—	—	—	—	(526)	(17)	(543)
Issuance of common stock under:									
Stock option and restricted stock plans	—	—	170	—	22,173	—	—	—	22,173
Sale of common stock	—	—	1,382	—	307,835	—	—	—	307,835
Equity based compensation costs	—	—	—	—	2,564	—	—	2,947	5,511
Reclassification of noncontrolling interest to redeemable noncontrolling interest	—	—	—	—	—	—	—	(144)	(144)
Changes in the redemption value of redeemable noncontrolling interest	—	—	—	—	(1,095)	—	—	—	(1,095)
Distributions to noncontrolling interest	—	—	—	—	—	—	—	(16,327)	(16,327)
Redemptions of noncontrolling interest	—	—	—	—	(2,199)	—	—	(422)	(2,621)
	—	—	—	—	—	(283,186)	—	—	(283,186)

Common and  
preferred stock  
dividends

Balances at

September 30, 2015	2,950	\$73,750	65,235	\$6	\$6,980,443	\$(782,801)	\$(50,357)	\$110,782	\$6,331,823
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See accompanying notes to the unaudited condensed consolidated financial statements.

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## ESSEX PROPERTY TRUST, INC. AND SUBSIDIARIES

## Condensed Consolidated Statements of Cash Flows

(Unaudited)

(In thousands)

	Nine Months Ended September 30,	
	2015	2014
Cash flows from operating activities:		
Net income	\$162,477	\$89,633
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	336,946	253,890
Amortization of discount on marketable securities	(9,012)	(6,555)
Amortization of (premium) discount and debt financing costs, net	(15,064)	(4,987)
Gain on sale of marketable securities and other investments	(598)	(886)
Company's share of gain on the sales of co-investments	(469)	(3,211)
Earnings from co-investments	(15,493)	(17,854)
Operating distributions from co-investments	28,632	20,122
Gains on the sales of real estate and land	(7,112)	(38,853)
Non cash merger and integration expenses	—	7,562
Equity-based compensation	5,511	4,996
Gain on remeasurement of co-investments	(34,014)	—
Changes in operating assets and liabilities:		
Prepaid expense, receivables and other assets	(1,851)	8,923
Accounts payable and accrued liabilities	36,480	43,988
Other liabilities	1,475	1,393
Net cash provided by operating activities	487,908	358,161
Cash flows from investing activities:		
Additions to real estate:		
Acquisitions of real estate and acquisition related capital expenditures	(327,799)	(438,088)
Redevelopment	(66,783)	(55,921)
Development acquisitions of and additions to real estate under development	(138,101)	(108,659)
Capital expenditures on rental properties	(42,809)	(21,074)
Acquisition of membership interest in co-investments	(115,724)	—
Proceeds from insurance for property losses	12,044	29,160
Proceeds from dispositions of real estate	74,485	61,331
BRE merger consideration paid	—	(555,826)
Proceeds from dispositions of co-investments	31,556	13,900
Contributions to co-investments	(119,120)	(128,268)
Changes in restricted cash and refundable deposits	38,282	(39,482)
Purchases of marketable securities	(14,300)	(15,516)
Sales and maturities of marketable securities and other investments	7,566	6,275
Collections of notes and other receivables	—	76,585
Non-operating distributions from co-investments	382	23,248
Net cash used in investing activities	(660,321)	(1,152,335)
Cash flows from financing activities:		
Borrowings under debt agreements	1,068,032	1,737,322
Repayment of debt	(924,844)	(1,327,840)
Additions to deferred charges	(4,320)	(16,941)
Net proceeds from issuance of common stock	307,835	449,464
Net proceeds from stock options exercises	22,173	6,526

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Distributions to noncontrolling interest	(15,789	) (13,217	)
Redemption of noncontrolling interest	(2,621	) (4,707	)
Common and preferred stock dividends paid	(272,000	) (177,400	)
Net cash provided by financing activities	178,466	653,207	

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	Nine Months Ended September	
	2015	2014
Cash acquired from the BRE merger	—	140,353
Cash acquired in consolidation of co-investment	4,005	—
Net increase (decrease) in cash and cash equivalents	10,058	(614 )
Cash and cash equivalents at beginning of period	25,610	18,491
Cash and cash equivalents at end of period	\$35,668	\$17,877
Supplemental disclosure of cash flow information:		
Cash paid for interest, net of \$12.2 million and \$17.8 million capitalized in 2015 and 2014, respectively	\$135,736	\$93,342
Supplemental disclosure of noncash investing and financing activities:		
Issuance of Operating Partnership units for contributed properties	\$—	\$1,419,816
Retirement of Operating Partnership units	\$—	\$(1,419,816 )
Transfer from real estate under development to rental properties	\$308,069	\$71,496
Transfer from real estate under development to co-investments	\$5,913	\$81,332
Reclassifications of and changes in redeemable noncontrolling interest from additional paid in capital and noncontrolling interest	\$1,333	\$18,764
Debt assumed in connection with acquisition of co-investment	\$114,435	\$—

See accompanying notes to the unaudited condensed consolidated financial statements.

## ESSEX PORTFOLIO, L.P. AND SUBSIDIARIES

## Condensed Consolidated Balance Sheets

(Unaudited)

(In thousands, except unit amounts)

	September 30, 2015	December 31, 2014
<b>ASSETS</b>		
Real estate:		
Rental properties:		
Land and land improvements	\$2,566,586	\$2,424,930
Buildings and improvements	9,753,982	8,819,751
	12,320,568	11,244,681
Less accumulated depreciation	(1,858,134 )	(1,564,806 )
	10,462,434	9,679,875
Real estate under development	226,690	429,096
Co-investments	1,036,043	1,042,423
Real estate held for sale, net	8,742	56,300
	11,733,909	11,207,694
Cash and cash equivalents-unrestricted	35,668	25,610
Cash and cash equivalents-restricted	36,638	70,139
Marketable securities and other investments	133,058	117,240
Notes and other receivables	22,668	24,923
Acquired in place lease value , net	12,675	47,748
Prepaid expenses and other asset	38,101	33,378
Total assets	\$12,012,717	\$11,526,732
<b>LIABILITIES AND CAPITAL</b>		
Unsecured debt, net	\$3,090,896	\$2,603,548
Mortgage notes payable, net	2,224,513	2,234,317
Lines of credit, net	2,011	242,824
Accounts payable and accrued liabilities	177,807	135,162
Construction payable	26,411	30,892
Distributions payable	99,945	88,221
Other liabilities	34,722	32,444
Total liabilities	5,656,305	5,367,408
Commitments and contingencies		
Redeemable noncontrolling interest	24,589	23,256
Capital:		
General Partner:		
Common equity (65,234,597 and 63,682,646 units issued and outstanding, respectively)	6,200,189	6,002,915
Series H 7.125% Preferred interest (liquidation value of \$73,750)	71,209	71,209
	6,271,398	6,074,124
Limited Partners:		
Common equity (2,176,563 and 2,168,158 units issued and outstanding, respectively)	46,793	48,665
Accumulated other comprehensive loss	(48,224 )	(49,356 )
Total partners' capital	6,269,967	6,073,433
Noncontrolling interest	61,856	62,635
Total capital	6,331,823	6,136,068

Total liabilities and capital	\$12,012,717	\$11,526,732
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See accompanying notes to the unaudited condensed consolidated financial statements.

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## ESSEX PORTFOLIO, L.P. AND SUBSIDIARIES

## Condensed Consolidated Statements of Income and Comprehensive Income

(Unaudited)

(In thousands, except unit and per unit amounts)

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2015	2014	2015	2014
Revenues:				
Rental and other property	\$302,522	\$268,512	\$876,852	\$684,813
Management and other fees from affiliates	2,104	2,361	6,809	6,856
	304,626	270,873	883,661	691,669
Expenses:				
Property operating, excluding real estate taxes	60,528	56,294	173,547	146,474
Real estate taxes	33,591	31,768	97,820	77,452
Depreciation and amortization	116,308	102,286	336,946	253,890
General and administrative	11,129	11,479	31,223	28,621
Merger and integration expenses	—	3,857	3,798	46,413
Acquisition and investment related costs	381	51	1,357	768
	221,937	205,735	644,691	553,618
Earnings from operations	82,689			