

Terreno Realty Corp  
Form 10-Q  
November 01, 2018  
Table of Contents

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
**Washington, D.C. 20549**

**Form 10-Q**

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

**For the quarterly period ended September 30, 2018**

**OR**

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

**For the transition period from \_\_\_\_\_ to \_\_\_\_\_**

**Commission file number 001-34603**

**Terreno Realty Corporation**  
**(Exact Name of Registrant as Specified in Its Charter)**

**Maryland**  
**(State or Other Jurisdiction of**

**27-1262675**  
**(I.R.S. Employer**

**Incorporation or Organization)**

**Identification No.)**

**101 Montgomery Street, Suite 200**

**San Francisco, CA**  
**(Address of Principal Executive Offices)**

**94104**  
**(Zip Code)**

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

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

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted 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 such files). Yes No

**Table of Contents**

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

Emerging growth company

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

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

The registrant had 59,136,072 shares of its common stock, \$0.01 par value per share, outstanding as of October 30, 2018.

**Table of Contents**

**Terreno Realty Corporation**

**Table of Contents**

**PART I. FINANCIAL INFORMATION**

<b>Item 1.</b>	<b><u>Financial Statements of Terreno Realty Corporation (unaudited)</u></b>	
	<b><u>Consolidated Balance Sheets as of September 30, 2018 and December 31, 2017</u></b>	<b>2</b>
	<b><u>Consolidated Statements of Operations for the three and nine months ended September 30, 2018 and 2017</u></b>	<b>3</b>
	<b><u>Consolidated Statements of Comprehensive Income (Loss) for the three and nine months ended September 30, 2018 and 2017</u></b>	<b>4</b>
	<b><u>Consolidated Statement of Equity for the nine months ended September 30, 2018</u></b>	<b>5</b>
	<b><u>Consolidated Statements of Cash Flows for the nine months ended September 30, 2018 and 2017</u></b>	<b>6</b>
	<b><u>Condensed Notes to Consolidated Financial Statements</u></b>	<b>7</b>
<b>Item 2.</b>	<b><u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u></b>	<b>23</b>
<b>Item 3.</b>	<b><u>Quantitative and Qualitative Disclosures About Market Risk</u></b>	<b>43</b>
<b>Item 4.</b>	<b><u>Controls and Procedures</u></b>	<b>43</b>

**PART II. OTHER INFORMATION**

<b>Item 1.</b>	<b><u>Legal Proceedings</u></b>	<b>44</b>
<b>Item 1A.</b>	<b><u>Risk Factors</u></b>	<b>44</b>
<b>Item 2.</b>	<b><u>Unregistered Sales of Equity Securities and Use of Proceeds</u></b>	<b>44</b>
<b>Item 3.</b>	<b><u>Defaults Upon Senior Securities</u></b>	<b>44</b>
<b>Item 4.</b>	<b><u>Mine Safety Disclosures</u></b>	<b>44</b>
<b>Item 5.</b>	<b><u>Other Information</u></b>	<b>44</b>
<b>Item 6.</b>	<b><u>Exhibits</u></b>	<b>44</b>
	<b><u>SIGNATURES</u></b>	<b>45</b>

**Table of Contents****PART I. FINANCIAL INFORMATION****Item 1. Financial Statements of Terreno Realty Corporation****Terreno Realty Corporation****Consolidated Balance Sheets****(in thousands except share and per share data)**

	<i>September 30, 2018</i>	<i>December 31, 2017</i>
	<i>(Unaudited)</i>	
<b>ASSETS</b>		
Investments in real estate		
Land	\$ 803,148	\$ 759,659
Buildings and improvements	823,921	801,242
Construction in progress	91,055	
Intangible assets	79,414	76,029
Total investments in properties	1,797,538	1,636,930
Accumulated depreciation and amortization	(162,150)	(139,814)
Net investments in properties	1,635,388	1,497,116
Properties held for sale, net	2,538	
Net investments in real estate	1,637,926	1,497,116
Cash and cash equivalents	3,587	35,710
Restricted cash	4,466	7,090
Senior secured loan, net	54,345	
Other assets, net	30,924	27,955
Total assets	\$ 1,731,248	\$ 1,567,871
<b>LIABILITIES AND EQUITY</b>		
Liabilities		
Credit facility	\$ 21,850	\$
Term loans payable, net	149,114	148,897
Senior unsecured notes, net	248,188	247,955
Mortgage loans payable, net	63,502	64,831
Security deposits	11,340	11,058
Intangible liabilities, net	24,063	22,361
Dividends payable	14,186	12,181
Performance share awards payable	9,310	11,824
Accounts payable and other liabilities	22,666	21,270
Total liabilities	564,219	540,377

Edgar Filing: Terreno Realty Corp - Form 10-Q

Commitments and contingencies (Note 12)		
Equity		
Stockholders' equity		
Common stock: \$0.01 par value, 400,000,000 shares authorized, and 59,136,072 and 55,368,737 shares issued and outstanding, respectively	592	553
Additional paid-in capital	1,161,395	1,023,184
Retained earnings	5,856	4,803
Accumulated other comprehensive loss	(814)	(1,046)
Total stockholders' equity	1,167,029	1,027,494
Total liabilities and equity	\$ 1,731,248	\$ 1,567,871

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

**Table of Contents****Terreno Realty Corporation****Consolidated Statements of Operations**

(in thousands except share and per share data)

(Unaudited)

*For the Three Months Ended September 30, 2018 and 2017 and for the Nine Months Ended September 30, 2018 and 2017*

	<i>2018</i>	<i>2017</i>	<i>2018</i>	<i>2017</i>
<b>REVENUES</b>				
Rental revenues	\$ 29,702	\$ 26,452	\$ 87,342	\$ 76,629
Tenant expense reimbursements	8,197	7,188	24,902	21,230
Total revenues	37,899	33,640	112,244	97,859
<b>COSTS AND EXPENSES</b>				
Property operating expenses	9,486	9,023	29,692	26,022
Depreciation and amortization	10,057	9,595	30,566	27,855
General and administrative	5,047	5,041	15,132	15,250
Acquisition costs	122		129	11
Total costs and expenses	24,712	23,659	75,519	69,138
<b>OTHER INCOME (EXPENSE)</b>				
Interest and other income	1,341	17	2,323	75
Interest expense, including amortization	(4,406)	(4,514)	(13,717)	(12,086)
Gain on sales of real estate investments		15,449	14,986	25,549
Total other income and expenses	(3,065)	10,952	3,592	13,538
Net income	10,122	20,933	40,317	42,259
Redemption of preferred stock		(1,767)		(1,767)
Preferred stock dividends		(178)		(1,961)
Net income, net of redemption of preferred stock and preferred stock dividends	10,122	18,988	40,317	38,531
Allocation to participating securities	(66)	(136)	(256)	(277)
Net income available to common stockholders, net of redemption of preferred stock and preferred stock dividends	\$ 10,056	\$ 18,852	\$ 40,061	\$ 38,254

**EARNINGS PER COMMON  
SHARE - BASIC AND DILUTED:**

Net income available to common stockholders, net of redemption of preferred stock and preferred stock dividends	\$	0.17	\$	0.36	\$	0.71	\$	0.76
---	----	------	----	------	----	------	----	------

**BASIC AND DILUTED  
WEIGHTED AVERAGE  
COMMON SHARES  
OUTSTANDING**

	58,369,252	52,804,611	56,743,805	50,277,432
--	------------	------------	------------	------------

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



**Table of Contents**

**Terreno Realty Corporation**  
**Consolidated Statements of Comprehensive Income (Loss)**

(in thousands)

(Unaudited)

*For the Three Months Ended September 30, 2018 and Nine Months Ended September 30,*

	<i>2018</i>	<i>2017</i>	<i>2018</i>	<i>2017</i>
Net income	\$ 10,122	\$ 20,933	\$ 40,317	\$ 42,259
Other comprehensive income (loss):				
cash flow hedge adjustment	70	8	232	(182)
Comprehensive income	\$ 10,192	\$ 20,941	\$ 40,549	\$ 42,077

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

**Table of Contents**

**Terreno Realty Corporation**  
**Consolidated Statement of Equity**  
(in thousands except share data)  
**(Unaudited)**

	<b>Common Stock</b>		<b>Additional</b>	<b>Retained</b>	<b>Accumulated Other Comprehensive</b>	<b>Total</b>
	<b>Number of Shares</b>	<b>Amount</b>	<b>Paid- in Capital</b>	<b>Earnings</b>	<b>Loss</b>	
Balance as of December 31, 2017	55,368,737	\$ 553	\$ 1,023,184	\$ 4,803	\$ (1,046)	\$ 1,027,494
Net income				40,317		40,317
Issuance of common stock, net of issuance costs of \$2,295	3,820,687	39	140,306			140,345
Repurchase of common stock	(107,267)		(3,870)			(3,870)
Issuance of restricted stock	53,915					
Stock-based compensation			1,775			1,775
Common stock dividends				(39,264)		(39,264)
Other comprehensive income					232	232
Balance as of September 30, 2018	59,136,072	\$ 592	\$ 1,161,395	\$ 5,856	\$ (814)	\$ 1,167,029

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

**Table of Contents****Terreno Realty Corporation****Consolidated Statements of Cash Flows****(in thousands)****(Unaudited)***For the Nine Months Ended September 30,*

	<b>2018</b>	<b>2017</b>
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Net income	\$ 40,317	\$ 42,259
Adjustments to reconcile net income to net cash provided by operating activities		
Straight-line rents	(2,937)	(2,865)
Amortization of lease intangibles	(2,678)	(1,521)
Depreciation and amortization	30,566	27,855
Gain on sales of real estate investments	(14,986)	(25,549)
Deferred financing cost amortization	1,081	866
Deferred senior secured loan fee amortization	(245)	
Stock-based compensation	6,022	7,261
Changes in assets and liabilities		
Other assets	(2,359)	937
Accounts payable and other liabilities	2,225	4,408
Net cash provided by operating activities	57,006	53,651
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Cash paid for property acquisitions	(169,143)	(190,108)
Proceeds from sales of real estate investments, net	42,991	64,183
Additions to construction in progress	(5,006)	
Additions to buildings, improvements and leasing costs	(19,685)	(18,936)
Cash paid for senior secured loan	(55,000)	
Origination and other fees received on senior secured loan	900	
Net cash used in investing activities	(204,943)	(144,861)
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Issuance of common stock	135,879	224,469
Issuance costs on issuance of common stock	(1,971)	(3,295)
Repurchase of common stock	(3,870)	(3,436)
Repurchase of preferred stock		(46,000)
Borrowings on credit facility	141,850	93,000
Payments on credit facility	(120,000)	(144,500)
Borrowings on senior unsecured notes		100,000
Payments on mortgage loans payable	(1,425)	(1,451)
Payment of deferred financing costs	(14)	(872)

Edgar Filing: Terreno Realty Corp - Form 10-Q

Dividends paid to common stockholders	(37,259)	(29,861)
Dividends paid to preferred stockholders		(1,999)
Net cash provided by financing activities	113,190	186,055
Net (decrease) increase in cash and cash equivalents and restricted cash	(34,747)	94,845
Cash and cash equivalents and restricted cash at beginning of period	42,800	18,478
Cash and cash equivalents and restricted cash at end of period	\$ 8,053	\$ 113,323

**SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION**

Cash paid for interest, net of capitalized interest	\$ 15,616	\$ 10,917
Supplemental disclosures of non-cash transactions		
Accounts payable related to capital improvements	\$ 6,283	\$ 7,770
Redemption of preferred stock		1,729
Reconciliation of cash paid for property acquisitions		
Acquisition of properties	\$ 174,134	\$ 209,738
Assumption of other assets and liabilities	(4,991)	(19,630)
Net cash paid for property acquisitions	\$ 169,143	\$ 190,108

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

**Table of Contents**

**Terreno Realty Corporation**

**Condensed Notes to Consolidated Financial Statements**

**(Unaudited)**

**Note 1. Organization**

Terreno Realty Corporation ( Terreno , and together with its subsidiaries, the Company ) acquires, owns and operates industrial real estate in six major coastal U.S. markets: Los Angeles, Northern New Jersey/New York City, San Francisco Bay Area, Seattle, Miami, and Washington, D.C. All square feet, acres, occupancy and number of properties disclosed in these condensed notes to the consolidated financial statements are unaudited. As of September 30, 2018, the Company owned 203 buildings (including one building held for sale) aggregating approximately 12.9 million square feet, 13 improved land parcels consisting of approximately 52.9 acres and four buildings under redevelopment expected to contain approximately 0.5 million square feet upon completion.

The Company is an internally managed Maryland corporation and elected to be taxed as a real estate investment trust ( REIT ) under Sections 856 through 860 of the Internal Revenue Code of 1986, as amended (the Code ), commencing with its taxable year ended December 31, 2010.

**Note 2. Significant Accounting Policies**

**Basis of Presentation.** The accompanying unaudited interim consolidated financial statements of the Company have been prepared in accordance with accounting principles generally accepted in the United States of America ( GAAP ) for interim financial information and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, they do not include all of the information and disclosures required by GAAP for annual financial statements. In management 's opinion, all adjustments (consisting of normal recurring adjustments) considered necessary for a fair presentation have been included. The interim consolidated financial statements include all of the Company 's accounts and its subsidiaries and all intercompany balances and transactions have been eliminated in consolidation. The financial statements should be read in conjunction with the financial statements contained in the Company 's 2017 Annual Report on Form 10-K and the notes thereto, which was filed with the Securities and Exchange Commission on February 7, 2018.

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

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

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

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

---

**Table of Contents**

**Impairment.** Carrying values for financial reporting purposes are reviewed for impairment on a property-by-property basis whenever events or changes in circumstances indicate that the carrying value of a property may not be fully recoverable. Examples of such events or changes in circumstances may include classifying an asset to be held for sale, changing the intended hold period or when an asset remains vacant significantly longer than expected. The intended use of an asset either held for sale or held for use can significantly impact how impairment is measured. If an asset is intended to be held for the long-term, the recoverability is based on the undiscounted future cash flows. If the asset carrying value is not supported on an undiscounted future cash flow basis, then the asset carrying value is measured against the lower of cost or the present value of expected cash flows over the expected hold period. An impairment charge to earnings is recognized for the excess of the asset's carrying value over the lower of cost or the present values of expected cash flows over the expected hold period. If an asset is intended to be sold, impairment is determined using the estimated fair value less costs to sell. The estimation of expected future net cash flows is inherently uncertain and relies on assumptions, among other things, regarding current and future economic and market conditions and the availability of capital. The Company determines the estimated fair values based on its assumptions regarding rental rates, lease-up and holding periods, as well as sales prices. When available, current market information is used to determine capitalization and rental growth rates. If available, current comparative sales values may also be used to establish fair value. When market information is not readily available, the inputs are based on the Company's understanding of market conditions and the experience of the Company's management team. Actual results could differ significantly from the Company's estimates. The discount rates used in the fair value estimates represent a rate commensurate with the indicated holding period with a premium layered on for risk. There were no impairment charges recorded to the carrying values of the Company's properties during the three or nine months ended September 30, 2018 or 2017.

**Loans Held-for-Investment.** Loans that are held-for-investment are carried at cost, net of loan fees and origination costs, as applicable, unless the loans are deemed impaired. Impairment occurs when it is deemed probable that the Company will not be able to collect all amounts due according to the contractual terms of loans that are held-for-investment. The Company evaluates its senior secured loan (the Senior Secured Loan), which is classified as held-for-investment, for impairment quarterly. If the Senior Secured Loan is considered to be impaired, the Company records an allowance through the provision for Senior Secured Loan losses to reduce the carrying value of the Senior Secured Loan to the present value of expected future cash flows discounted at the Senior Secured Loan's contractual effective rate or the fair value of the collateral, if repayment is expected solely from the collateral. Actual losses, if any, could differ significantly from the Company's estimates. There were no impairment charges recorded to the carrying value of the Senior Secured Loan during the three or nine months ended September 30, 2018 or 2017.

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

Edgar Filing: Terreno Realty Corp - Form 10-Q

acquisitions are capitalized to individual tangible and intangible assets and liabilities assumed on a relative fair value basis and acquisition-related costs associated with business combinations are expensed as incurred.

The fair value of the tangible assets is determined by valuing the property as if it were vacant. Land values are derived from current comparative sales values, when available, or management's estimates of the fair value based on market conditions and the experience of the Company's management team. Building and improvement values are calculated as replacement cost less depreciation, or management's estimates of the fair value of these assets using discounted cash flow analyses or similar methods. The fair value of the above and below-market leases is based on the present value of the difference between the contractual amounts to be received pursuant to the acquired leases (using a discount rate that reflects the risks associated with the acquired leases) and the Company's estimate of the market lease rates measured over a period equal to the remaining term of the leases plus the term of any below-market fixed rate renewal options. The above and below-market lease values are amortized to rental revenues over the remaining initial term plus the term of any below-market fixed rate renewal options that are considered bargain renewal options of the respective leases. The total net impact to rental revenues due to the amortization of above and below-market leases was a net increase of approximately \$0.9 million and \$0.7 million, respectively, for the three months ended September 30, 2018 and 2017, and approximately \$2.7 million and \$1.5 million, respectively, for the nine months ended September 30, 2018 and 2017. The origination value of in-place leases is based on costs to execute similar leases, including commissions and other related costs. The origination value of in-place leases also includes real estate taxes, insurance and an estimate of lost rental revenue at market rates during the estimated time required to lease up the property from vacant to the occupancy level at the date of acquisition. The remaining weighted average lease term related to these intangible assets and liabilities as of September 30, 2018 is 9.0 years. As of September 30, 2018 and December 31, 2017, the Company's intangible assets and liabilities, including properties held for sale (if any), consisted of the following (dollars in thousands):

	September 30, 2018			December 31, 2017		
	Gross	Accumulated Amortization	Net	Gross	Accumulated Amortization	Net
In-place leases	\$ 75,644	\$ (50,457)	\$ 25,187	\$ 71,502	\$ (45,885)	\$ 25,617
Above-market leases	4,170	(3,543)	627	4,527	(3,695)	832
Below-market leases	(34,613)	10,550	(24,063)	(30,386)	8,025	(22,361)
Total	\$ 45,201	\$ (43,450)	\$ 1,751	\$ 45,643	\$ (41,555)	\$ 4,088



**Table of Contents**

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

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

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

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

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

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

	<i>For the Nine Months Ended September 30,</i>	
	<b>2018</b>	<b>2017</b>
<b>Beginning</b>		
Cash and cash equivalents at beginning of period	\$ 35,710	\$ 14,208
Restricted cash	7,090	4,270
Cash and cash equivalents and restricted cash	42,800	18,478
<b>Ending</b>		
Cash and cash equivalents at end of period	3,587	109,058
Restricted cash	4,466	4,265
Cash and cash equivalents and restricted cash	8,053	113,323
<b>Net (decrease) increase in cash and cash equivalents and restricted cash</b>	<b>\$ (34,747)</b>	<b>\$ 94,845</b>



---

**Table of Contents**

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

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

As of September 30, 2018 and December 31, 2017, approximately \$25.2 million and \$23.0 million, respectively, of straight-line rent and accounts receivable, net of allowances of approximately \$0.2 million and \$0.1 million as of September 30, 2018 and December 31, 2017, respectively, were included as a component of other assets in the accompanying consolidated balance sheets.

**Deferred Financing Costs.** Costs incurred in connection with financings are capitalized and amortized to interest expense using the effective interest method over the term of the related loan. Deferred financing costs associated with the revolving credit facility are classified as an asset and deferred financing costs associated with debt liabilities are reported as a direct deduction from the carrying amount of the debt liability in the accompanying consolidated balance sheets. Deferred financing costs related to the revolving credit facility and debt liabilities are shown at cost, net of accumulated amortization in the aggregate of approximately \$6.6 million and \$5.7 million as of September 30, 2018 and December 31, 2017, respectively.

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

ASC 740-10, *Income Taxes*, provides guidance for how uncertain tax positions should be recognized, measured, presented and disclosed in the financial statements. ASC 740-10 requires the evaluation of tax positions taken in the course of preparing the Company's tax returns to determine whether the tax positions are more-likely-than-not of being sustained by the applicable tax authority. Tax benefits of positions not deemed to meet the more-likely-than-not threshold are recorded as a tax expense in the current year. As of September 30, 2018 and December 31, 2017, the

Company did not have any unrecognized tax benefits and does not believe that there will be any material changes in unrecognized tax positions over the next 12 months. The Company's tax returns are subject to examination by federal, state and local tax jurisdictions beginning with the 2010 calendar year.

***Stock-Based Compensation and Other Long-Term Incentive Compensation.*** The Company follows the provisions of ASC 718, *Compensation-Stock Compensation*, to account for its stock-based compensation plan, which requires that the compensation cost relating to stock-based payment transactions be recognized in the financial statements and that the cost be measured on the fair value of the equity or liability instruments issued. The Company has adopted the Amended and Restated 2010 Equity Incentive Plan, which provides for the grant of restricted stock awards, performance share awards, unrestricted shares or any combination of the foregoing. Stock-based compensation is recognized as a general and administrative expense in the accompanying consolidated statements of operations and measured at the fair value of the award on the date of grant. The Company estimates the forfeiture rate based on historical experience as well as expected behavior. The amount of the expense may be subject to adjustment in future periods depending on the specific characteristics of the stock-based award.

---

**Table of Contents**

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

***Use of Derivative Financial Instruments.*** ASC 815, *Derivatives and Hedging* (Note 8), provides the disclosure requirements for derivatives and hedging activities with the intent to provide users of financial statements with an enhanced understanding of: (a) how and why the Company uses derivative instruments, (b) how the Company accounts for derivative instruments and related hedged items, and (c) how derivative instruments and related hedged items affect the Company's financial position, financial performance, and cash flows. Further, qualitative disclosures are required that explain the Company's objectives and strategies for using derivatives, as well as quantitative disclosures about the fair value of and gains and losses on derivative instruments.

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

As of September 30, 2018, the Company had three interest rate caps to hedge the variable cash flows associated with its existing \$150.0 million of variable-rate term loans. The caps have a notional value of \$150.0 million and will effectively cap the annual interest rate at 4.0% plus 1.30% to 1.85%, depending on leverage, with respect to \$50.0 million for the period from December 1, 2014 (effective date) to May 1, 2021, \$50.0 million for the period from September 1, 2015 (effective date) to April 1, 2019, and \$50.0 million for the period from September 1, 2015 (effective date) to February 3, 2020. The Company records all derivative instruments on a gross basis in other assets on the accompanying consolidated balance sheets, and accordingly, there are no offsetting amounts that net assets against liabilities. As of September 30, 2018 and December 31, 2017, the fair value of the interest rate caps was approximately \$0.1 million and \$30,000, respectively.

***Fair Value of Financial Instruments.*** ASC 820, *Fair Value Measurements and Disclosures* (Note 9), defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. ASC 820 also provides guidance for using fair value to measure financial assets and liabilities. ASC 820 requires disclosure of the level within the fair value hierarchy in which the fair value measurements fall, including measurements using quoted prices in active markets for identical assets or liabilities (Level 1), quoted prices for similar instruments in active markets or quoted prices for identical or similar instruments

in markets that are not active (Level 2), and significant valuation assumptions that are not readily observable in the market (Level 3).

**Table of Contents**

***New Accounting Standards.*** In May 2014, the Financial Accounting Standards Board ( FASB ) issued ASU 2014-09, which created ASC Topic 606, *Revenue from Contracts with Customers*, which is their final standard on revenue from contracts with customers. ASU 2014-09 outlines a single comprehensive model for entities to use in accounting for revenues arising from contracts with customers. The effective date of ASU 2014-09 was deferred by the issuance of ASU 2015-14, *Revenue from Contracts with Customers (Topic 606): Deferral of the Effective Date*, by one year to make the guidance of ASU 2014-09 effective for annual reporting periods beginning after December 15, 2017, including interim periods therein. In March 2016, the FASB issued ASU 2016-08, *Revenue from Contracts with Customers (Topic 606): Principal versus Agent Considerations (Reporting Revenue Gross versus Net)*, which clarifies how to apply the implementation guidance on principal versus agent considerations related to the sale of goods or services to a customer as updated by ASU 2014-09. In April 2016, the FASB issued ASU 2016-10, *Revenue from Contracts with Customers (Topic 606): Identifying Performance Obligations and Licensing*, which clarifies two aspects of Topic 606: (1) identifying performance obligations and (2) the licensing implementation guidance, while retaining the related principles for those areas. The effective date and transition requirements for ASU 2016-10 are the same as the effective date and transition requirements in ASU 2015-14. In May 2016, the FASB issued ASU 2016-12, *Revenue from Contracts with Customers (Topic 606): Narrow-Scope Improvements and Practical Expedients*, which makes narrow scope amendments to Topic 606, including implementation issues on collectability, non-cash consideration and completed contracts at transition. In December 2016, the FASB issued ASU 2016-20, *Technical Corrections and Improvements to Topic 606, Revenue from Contracts with Customers*, which make additional narrow scope amendments to Topic 606, including loan guarantee fees, impairment testing of contract costs, provisions for losses on construction-type and production-type contracts. The FASB allows two adoption methods under ASU 2014-09. Under one method, a company will apply the rules to contracts in all reporting periods presented, subject to certain allowable exceptions. Under the other method, a company will apply the rules to all contracts existing as of January 1, 2018, recognizing in beginning retained earnings an adjustment for the cumulative effect of the change and providing additional disclosures comparing results to previous rules ( modified retrospective method ). Based on the Company's evaluation of contracts within the scope of ASU 2014-09, the guidance impacts revenue related to the sales of real estate, which is evaluated in conjunction with ASC 610-20, *Other Income - Gains and Losses from the Derecognition of Nonfinancial Assets* (see below). The Company's rental revenues and recoveries earned from leasing operating properties are excluded from this standard and will be assessed with the adoption of ASU 2016-02, *Leases* (see below). The Company adopted ASU 2014-09 as of January 1, 2018 using the modified retrospective method. As a result of adoption of the standard, there was no material impact to the Company's consolidated financial statements.

Effective January 1, 2018, the Company adopted the guidance of ASC 610-20, *Other Income - Gains and Losses from the Derecognition of Nonfinancial Assets*, which applies to sales or transfers to noncustomers of nonfinancial assets or in substance nonfinancial assets that do not meet the definition of a business. Generally, the Company's sales of real estate would be considered a sale of a nonfinancial asset as defined by ASC 610-20. ASC 610-20 refers to the revenue recognition principles under ASU 2014-09, *Revenue from Contracts with Customers* (see above). Under ASC 610-20, if the Company determines it does not have a controlling financial interest in the entity that holds the asset and the arrangement meets the criteria to be accounted for as a contract, the Company would derecognize the asset and recognize a gain or loss on the sale of the real estate when control of the underlying asset transfers to the buyer. As a result of adoption of the standard, there was no material impact to the Company's consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02, *Leases* (Topic 842). The ASU increases transparency and comparability among organizations by recognizing lease assets and liabilities on the balance sheet and disclosing key information about leasing arrangements. The standard requires that non-lease components, such as tenant expense reimbursement revenues, be accounted for in accordance with ASU 2014-09, *Revenue from Contracts with Customers* (see above), which could change the classification and timing of its non-lease components. The ASU is effective for fiscal years beginning after December 15, 2018, including interim periods within those years, which for the Company would be the first quarter of 2019, and early adoption is permitted. The standard is not expected to have a material

effect on the Company's financial statements from a lessee perspective. In July 2018, the FASB issued ASU 2018-11, *Leases (Topic 842): Targeted Improvements*, which allows lessors to elect a practical expedient by class of underlying assets to not separate non-lease components from the lease component if certain conditions are met. The lessor's practical expedient election would be limited to circumstances in which the non-lease components otherwise would be accounted for under the new revenue guidance and both (i) the timing and pattern of transfer are the same for the non-lease component and the related lease component and (ii) the non-lease component is not the predominant component of the arrangement. The Company expects to elect the practical expedient which would allow the Company the ability to combine the lease and non-lease components if the underlying asset meets the criteria above. ASU 2018-11 also includes an optional transition method in addition to the existing requirements for transition to the new standard by recognizing a cumulative effect adjustment to the opening balance sheet of retained earnings in the period of adoption. Consequently, a company's reporting for the comparative periods presented in the financial statements would continue to be in accordance with current GAAP (Topic 840). The Company plans to elect this practical expedient as well. The Company plans to adopt the provisions of ASU No. 2016-02 and ASU No. 2018-11 effective January 1, 2019 using the modified retrospective approach and plans to apply the package of practical expedients available to the Company upon adoption. The Company is currently assessing the potential changes to its accounting and whether such changes will have a material impact on its consolidated financial statements and condensed notes to its consolidated financial statements, as well as its business processes, controls and systems. The Company does not expect that these changes will have a material effect on its financial position or results of operations. The Company does not currently capitalize internal leasing costs.

In August 2016, the FASB issued ASU 2016-15, *Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments*, which provides clarified guidance on the presentation and classification of certain cash receipts and cash payments in the statement of cash flows. ASU 2016-15 is effective for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years and early adoption was permitted. The Company adopted ASU 2016-15 as of January 1, 2018. As a result of adoption of the standard, there was no material impact to the Company's consolidated financial statements.



## **Table of Contents**

In May 2017, the FASB issued ASU 2017-09, *Compensation – Stock Compensation (Topic 718): Scope of Modification Accounting*, which provides clarified guidance regarding when changes to the terms or conditions of a share-based payment must be accounted for as a modification. The guidance will be applied prospectively to awards modified on or after the adoption date. ASU 2017-09 is effective for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years and early adoption was permitted. The Company adopted ASU 2017-09 as of January 1, 2018. As a result of adoption of the standard, there was no material impact to the Company's consolidated financial statements.

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

### **Note 3. Concentration of Credit Risk**

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

As of September 30, 2018, the Company owned 55 buildings aggregating approximately 3.1 million square feet and five land parcels consisting of approximately 26.9 acres located in Northern New Jersey/New York City, which accounted for a combined percentage of approximately 25.4% of its annualized base rent, and 36 buildings aggregating approximately 2.7 million square feet and three land parcels consisting of approximately 8.0 acres located in Los Angeles, which accounted for a combined percentage of approximately 18.7% of its annualized base rent. Such annualized base rent percentages are based on contractual base rent from leases in effect as of September 30, 2018, excluding any partial or full rent abatements.

Other real estate companies compete with the Company in its real estate markets. This results in competition for tenants to occupy space. The existence of competing properties could have a material impact on the Company's ability to lease space and on the level of rent that can be achieved. The Company had no tenants that accounted for greater than 10% of its rental revenues for the nine months ended September 30, 2018.

### **Note 4. Investments in Real Estate**

During the three months ended September 30, 2018, the Company acquired eight industrial buildings containing approximately 407,000 square feet and two improved land parcels containing approximately 1.4 acres. The total aggregate initial investment, including acquisition costs, was approximately \$70.4 million, of which \$44.6 million was recorded to land, \$22.3 million to buildings and improvements, \$3.5 million to intangible assets and \$1.9 million to intangible liabilities.

During the nine months ended September 30, 2018, the Company acquired 13 industrial buildings containing approximately 875,000 square feet, including two buildings under redevelopment that upon completion will contain approximately 318,000 square feet with a total expected investment of approximately \$95.6 million, including redevelopment costs of approximately \$27.8 million, and three improved land parcels containing approximately 5.0 acres. The total aggregate initial investment, including acquisition costs, was approximately \$174.1 million, of which

## Edgar Filing: Terreno Realty Corp - Form 10-Q

\$119.0 million was recorded to land, \$47.7 million to buildings and improvements, \$7.4 million to intangible assets and \$4.6 million to intangible liabilities.

The Company recorded revenues and net income for the three months ended September 30, 2018 of approximately \$1.2 million and \$0.4 million, respectively, and recorded revenues and net income for the nine months ended September 30, 2018 of approximately \$2.3 million and \$0.8 million, respectively, related to the 2018 acquisitions.

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

**Table of Contents**

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

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

The above assets and liabilities were recorded at fair value, which uses Level 3 inputs. The properties were acquired from unrelated third parties using existing cash on hand, proceeds from property sales, issuance of common stock and borrowings on the revolving credit facility.

During 2018, the Company began redevelopment on four buildings that upon completion will contain approximately 0.5 million square feet with a total expected investment of approximately \$119.0 million, including redevelopment costs of approximately \$32.7 million. The Company capitalized interest associated with redevelopment and expansion activities of approximately \$0.8 million and \$0, respectively, during the three months ended September 30, 2018 and 2017, and approximately \$1.6 million and \$0, respectively, during the nine months ended September 30, 2018 and 2017.

**Pro Forma Financial Information:**

The following supplementary pro forma financial information presents the results of operations of the Company for the three and nine months ended September 30, 2018 and 2017 as if all of the Company's acquisitions during the nine months ended September 30, 2018 occurred on January 1, 2017. The following pro forma results for the three and nine months ended September 30, 2018 and 2017 have been presented for comparative purposes only and are not necessarily indicative of the results of operations that would have actually occurred had all transactions taken place on January 1, 2017, or of future results of operations (dollars in thousands, except per share data).

	<i>For the Three Months Ended September 30,</i>		<i>Nine Months Ended September 30,</i>	
	<i>2018</i>	<i>2017</i>	<i>2018</i>	<i>2017</i>
Total revenues	\$ 38,533	\$ 35,094	\$ 115,701	\$ 103,582
Net income available to common stockholders, net of redemption of preferred stock and preferred stock dividends	10,365	19,292	41,246	39,975
Basic and diluted net income available to common stockholders per share, net of redemption of preferred stock and preferred stock dividends	\$ 0.18	\$ 0.37	\$ 0.73	\$ 0.80

**Note 5. Held for Sale/Disposed Assets**

The Company considers a property to be held for sale when it meets the criteria established under ASC 360, *Property, Plant, and Equipment*. Properties held for sale are reported at the lower of the carrying amount or fair value less

## Edgar Filing: Terreno Realty Corp - Form 10-Q

estimated costs to sell and are not depreciated while they are held for sale. As of September 30, 2018, the Company has entered into an agreement with a third-party purchaser to sell one building located in the Miami market for a sales price of approximately \$4.3 million (net book value of approximately \$2.5 million). The sale of the building is subject to various closing conditions.

**Table of Contents**

The following summarizes the condensed results of operations of the building held for sale as of September 30, 2018 for the three and nine months ended September 30, 2018 and 2017 (dollars in thousands):

	<i>For the Three Months Ended September 30,</i>		<i>For the Nine Months Ended September 30,</i>	
	<i>2018</i>	<i>2017</i>	<i>2018</i>	<i>2017</i>
Rental revenues	\$ 98	\$ 98	\$ 293	\$ 293
Tenant expense reimbursements	14	13	41	40
Property operating expenses	(17)	(16)	(50)	(49)
Depreciation and amortization	(10)	(26)	(63)	(78)
<b>Income from operations</b>	<b>\$ 85</b>	<b>\$ 69</b>	<b>\$ 221</b>	<b>\$ 206</b>

During the nine months ended September 30, 2018, the Company sold one property located in the Washington, D.C. market for a sales price of approximately \$20.3 million, resulting in a gain of approximately \$3.3 million, and one property located in the Miami market for a sales price of approximately \$24.3 million, resulting in a gain of approximately \$11.7 million.

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

**Note 6. Senior Secured Loan**

On May 7, 2018, the Company made a Senior Secured Loan of \$55.0 million with a two-year term that bears interest at a fixed annual interest rate of 8.0% and matures in May 2020. The Senior Secured Loan is secured by a portfolio of nine improved land parcels primarily located in Newark and Kearny, New Jersey. One of the properties securing the Senior Secured Loan may be put to the Company as partial repayment of the Senior Secured Loan. This property, and two of the other properties, may be called by the Company as partial or full repayment of the Senior Secured Loan at previously agreed upon values. In addition, per the terms of the Senior Secured Loan, the borrower may repay the loan at any time with either cash or deeds in lieu, with the deeds subject to the Company's approval. As of September 30, 2018, the borrower has offered repayment with deeds in lieu on two of the three option properties for an aggregate purchase price of approximately \$39.1 million. As of November 1, 2018, the Company has entered into two non-binding letters of intent to acquire two of the three option properties for approximately \$39.1 million. In the normal course of its business, the Company enters into non-binding letters of intent to purchase properties from third parties that may obligate the Company to make payments or perform other obligations upon the occurrence of certain events, including the execution of a purchase and sale agreement and satisfactory completion of various due diligence matters. There can be no assurance that the Company will enter into purchase and sale agreements with respect to these properties or otherwise complete any such prospective purchases on the terms described or at all. As of September 30, 2018 and December 31, 2017, there was approximately \$54.3 million and \$0, respectively, net of deferred loan fees of approximately \$0.7 million and \$0, respectively, outstanding on the Senior Secured Loan and approximately \$0.4 million and \$0, respectively, of interest receivable outstanding on the Senior Secured Loan. Interest receivable is included as a component of other assets in the accompanying consolidated balance sheets.

**Note 7. Debt**

## Edgar Filing: Terreno Realty Corp - Form 10-Q

As of September 30, 2018, the Company had \$50.0 million of senior unsecured notes that mature in September 2022, \$100.0 million of senior unsecured notes that mature in July 2024, \$50.0 million of senior unsecured notes that mature in July 2026, \$50.0 million of senior unsecured notes that mature in October 2027 (collectively, the Senior Unsecured Notes ), and a credit facility (the Facility ), which consists of a \$200.0 million unsecured revolving credit facility that matures in August 2020, a \$50.0 million term loan that matures in August 2021 and a \$100.0 million term loan that matures in January 2022. As of September 30, 2018 and December 31, 2017, there was \$21.9 million and \$0, respectively, of borrowings outstanding on the revolving credit facility and \$150.0 million and \$150.0 million, respectively, of borrowings outstanding on the term loans. As of both September 30, 2018 and December 31, 2017, the Company had three interest rate caps to hedge the variable cash flows associated with its existing \$150.0 million of variable-rate term loans. See Note 8-Derivative Financial Instruments for more information regarding the Company's interest rate caps.

**Table of Contents**

The following summary of the Facility is as of September 30, 2018. The aggregate amount of the Facility may be increased to a total of up to \$600.0 million, subject to the approval of the administrative agent and the identification of lenders willing to make available additional amounts. Outstanding borrowings under the Facility are limited to the lesser of (i) the sum of the \$150.0 million of term loans and the \$200.0 million revolving credit facility, or (ii) 60.0% of the value of the unencumbered properties. Interest on the Facility, including the term loans, is generally to be paid based upon, at the Company's option, either (i) LIBOR plus the applicable LIBOR margin or (ii) the applicable base rate which is the greatest of the administrative agent's prime rate, 0.50% above the federal funds effective rate, or thirty-day LIBOR plus the applicable LIBOR margin for LIBOR rate loans under the Facility plus 1.25%. The applicable LIBOR margin will range from 1.35% to 1.90% (1.35% as of September 30, 2018) for the revolving credit facility and 1.30% to 1.85% (1.30% as of September 30, 2018) for the \$50.0 million term loan that matures in August 2021 and the \$100.0 million term loan that matures in January 2022, depending on the ratio of the Company's outstanding consolidated indebtedness to the value of the Company's consolidated gross asset value. The Facility requires quarterly payments of an annual unused facility fee in an amount equal to 0.20% or 0.25% depending on the unused portion of the revolving credit facility.

The Facility and the Senior Unsecured Notes are guaranteed by the Company and by substantially all of the current and to-be-formed subsidiaries of the Company that own an unencumbered property. The Facility and the Senior Unsecured Notes are unsecured by the Company's properties or by interests in the subsidiaries that hold such properties. The Facility and the Senior Unsecured Notes include a series of financial and other covenants with which the Company must comply. The Company was in compliance with the covenants under the Facility and the Senior Unsecured Notes as of September 30, 2018 and December 31, 2017.

The Company has mortgage loans payable which are collateralized by certain of the properties and require monthly interest and principal payments until maturity and are generally non-recourse. The mortgage loans mature between 2019 and 2021. As of September 30, 2018, the Company had three mortgage loans payable, net of deferred financing costs, totaling approximately \$63.5 million, which bear interest at a weighted average fixed annual rate of 4.0%. As of December 31, 2017, the Company had three mortgage loans payable, net of deferred financing costs, totaling approximately \$64.8 million, which bore interest at a weighted average fixed annual interest rate of 4.0%. As of September 30, 2018 and December 31, 2017, the total gross book value of the properties securing the debt was approximately \$154.1 million and \$153.7 million, respectively.

The scheduled principal payments of the Company's debt as of September 30, 2018 were as follows (dollars in thousands):

	<b>Credit Facility</b>	<b>Term Loans</b>	<b>Senior Unsecured Notes</b>	<b>Mortgage Loans Payable</b>	<b>Total Debt</b>
2018 (3 months)	\$	\$	\$	\$ 485	\$ 485
2019				18,805	18,805
2020	21,850			33,077	54,927
2021		50,000		11,271	61,271
2022		100,000	50,000		150,000
Thereafter			200,000		200,000
<b>Total Debt</b>	21,850	150,000	250,000	63,638	485,488
Deferred financing costs, net		(886)	(1,812)	(136)	(2,834)

<b>Total Debt, net</b>	\$ 21,850	\$ 149,114	\$ 248,188	\$ 63,502	\$ 482,654
Weighted Average Interest Rate	3.5%	3.4%	4.1%	4.0%	3.8%

**Note 8. Derivative Financial Instruments****Risk Management Objective of Using Derivatives**

The Company is exposed to certain risk arising from both its business operations and economic conditions. The Company principally manages its exposures to a wide variety of business and operational risks through management of its core business activities. The Company manages economic risks, including interest rate, liquidity, and credit risk primarily by managing the amount, sources, and duration of its debt funding and the use of derivative financial instruments. Specifically, the Company enters into derivative financial instruments to manage exposures that arise from business activities that result in the payment of future known and uncertain cash amounts, the value of which are determined by interest rates. The Company's derivative financial instruments are used to manage differences in the amount, timing, and duration of its known or expected cash payments principally related to its borrowings.



**Table of Contents****Derivative Instruments**

The Company's objectives in using interest rate derivatives are to add stability to interest expense and to manage exposure to interest rate movements. To accomplish this objective, the Company primarily uses interest rate caps as part of its interest rate risk management strategy. Interest rate caps involve the receipt of variable amounts from a counterparty at the end of each period in which the interest rate exceeds the agreed fixed price. The Company does not use derivatives for trading or speculative purposes. The Company requires that hedging derivative instruments be highly effective in reducing the risk exposure that they are designated to hedge. As a result, there is no significant ineffectiveness from any of its derivative activities.

The accounting for changes in fair value (i.e., gains or losses) of a derivative instrument depends on whether it has been designated and qualifies as part of a hedging relationship and further, on the type of hedging relationship. Derivatives that are not designated as hedges must be adjusted to fair value through earnings. For a derivative that is designated and that qualifies as a cash flow hedge, the effective portion of the change in fair value of the derivative is initially recorded in accumulated other comprehensive income (loss) (AOCI). Amounts recorded in AOCI are subsequently reclassified into earnings in the period that the hedged forecasted transaction affects earnings. The ineffective portion of a derivative's change in fair value is immediately recognized in earnings.

As of September 30, 2018, the Company had three interest rate caps to hedge the variable cash flows associated with its existing \$150.0 million of variable-rate term loans. The caps have a notional value of \$150.0 million and will effectively cap the annual interest rate payable at 4.0% plus 1.30% to 1.85%, depending on leverage, with respect to \$50.0 million for the period from December 1, 2014 (effective date) to May 1, 2021, \$50.0 million for the period from September 1, 2015 (effective date) to April 1, 2019 and \$50.0 million for the period from September 1, 2015 (effective date) to February 3, 2020. The Company is required to make certain monthly variable rate payments on the term loans, while the applicable counterparty is obligated to make certain monthly floating rate payments based on LIBOR to the Company in the event LIBOR is greater than 4.0%, referencing the same notional amount.

The Company records all derivative instruments on a gross basis in other assets on the accompanying consolidated balance sheets, and accordingly, there are no offsetting amounts that net assets against liabilities. The following table presents a summary of the Company's derivative instruments designated as hedging instruments (dollars in thousands):

Derivative Instrument	Effective Date	Maturity Date	Interest Rate Strike	Fair Value		Notional Amount	
				December 31, 2018	September 30, 2017	December 31, 2018	December 31, 2017
<b>Assets:</b>							
Interest Rate Cap	12/1/2014	5/4/2021	4.0%	\$ 47	\$ 26	\$ 50,000	\$ 50,000
Interest Rate Cap	9/1/2015	4/1/2019	4.0%		1	50,000	50,000
Interest Rate Cap	9/1/2015	2/3/2020	4.0%	4	3	50,000	50,000
<b>Total</b>				<b>\$ 51</b>	<b>\$ 30</b>	<b>\$ 150,000</b>	<b>\$ 150,000</b>

The effective portion of changes in the fair value of derivatives designated and qualified as cash flow hedges is recorded in AOCI and will be reclassified to interest expense in the period that the hedged forecasted transaction affects earnings on the Company's variable rate debt. The ineffective portion of the change in fair value of the derivatives is recognized directly in earnings into interest expense.

Edgar Filing: Terreno Realty Corp - Form 10-Q

The following table presents the effect of the Company's derivative financial instruments on its accompanying consolidated statements of operations for the three and nine months ended September 30, 2018 and 2017 (in thousands):

	<i>For the Three Months Ended September 30,</i>		<i>For the Nine Months Ended September 30,</i>	
	<i>2018</i>	<i>2017</i>	<i>2018</i>	<i>2017</i>
Interest rate caps in cash flow hedging relationships:				
Amount of gain recognized in AOCI on derivatives (effective portion)	\$ 80	\$ 29	\$ 211	\$ 63
Amount of gain reclassified from AOCI into interest expense (effective portion)	\$ 80	\$ 29	\$ 211	\$ 63

The Company estimates that approximately \$0.3 million will be reclassified from AOCI as an increase to interest expense over the next twelve months.

**Table of Contents****Note 9. Fair Value Measurements**

ASC 820 requires disclosure of the level within the fair value hierarchy in which the fair value measurements fall, including measurements using quoted prices in active markets for identical assets or liabilities (Level 1), quoted prices for similar instruments in active markets or quoted prices for identical or similar instruments in markets that are not active (Level 2), and significant valuation assumptions that are not readily observable in the market (Level 3).

**Recurring Measurements Interest Rate Contracts*****Fair Value of Interest Rate Caps***

Currently, the Company uses interest rate cap agreements to manage its interest rate risk. The valuation of these instruments is determined using widely accepted valuation techniques including discounted cash flow analysis on the expected cash flows of the derivatives. This analysis reflects the contractual terms of the derivatives, including the period to maturity, and uses observable market-based inputs, including interest rate curves. As of September 30, 2018, the Company applied the provisions of this standard to the valuation of its interest rate caps.

The following sets forth the Company's financial instruments that are accounted for at fair value on a recurring basis as of September 30, 2018 and December 31, 2017 (dollars in thousands):

	<i>Fair Value Measurement Using</i>		
	<i>Quoted Price in</i>	<i>Significant</i>	
	<i>Active Markets for</i>	<i>Other</i>	<i>Significant</i>
	<i>Identical Assets</i>	<i>Observable</i>	<i>Unobservable</i>
	<i>and Liabilities</i>	<i>Inputs</i>	<i>Inputs</i>
	<i>Total Fair Value</i>	<i>(Level</i>	<i>(Level 3)</i>
	<i>(Level 1)</i>	<i>2)</i>	
<b>Assets</b>			
Interest rate caps at:			
September 30, 2018	\$ 51	\$	\$ 51
December 31, 2017	\$ 30	\$	\$ 30

***Financial Instruments Disclosed at Fair Value***

As of September 30, 2018 and December 31, 2017, the fair values of cash and cash equivalents, accounts receivable and accounts payable approximated their carrying values because of the short-term nature of these investments or liabilities based on Level 1 inputs. The fair values of the Company's derivative instruments were evaluated based on Level 2 inputs. The fair values of the Company's mortgage loans payable and Senior Unsecured Notes were estimated by calculating the present value of principal and interest payments, based on borrowing rates available to the Company, which are Level 2 inputs, adjusted with a credit spread, as applicable, and assuming the loans are outstanding through maturity. The fair value of the Company's Facility approximated its carrying value because the variable interest rates approximate market borrowing rates available to the Company, which are Level 2 inputs. The fair value of the Company's Senior Secured Loan approximated its carrying value because the interest rate approximates the market lending rate available to the borrower, which is a Level 2 input.

Edgar Filing: Terreno Realty Corp - Form 10-Q

The following table sets forth the carrying value and the estimated fair value of the Company's Senior Secured Loan and debt as of September 30, 2018 and December 31, 2017 (dollars in thousands):

	<i>Fair Value Measurement Using Quoted Price in</i>				
	<i>Active Markets</i>			<i>Significant</i>	
	<i>for Identical</i>		<i>Other</i>	<i>Significant</i>	
	<i>Assets</i>		<i>Observable</i>	<i>Unobservable</i>	
	<i>and</i>		<i>Inputs</i>	<i>Inputs</i>	
	<i>Liabilities</i>	<i>(Level 1)</i>	<i>(Level 2)</i>	<i>(Level 3)</i>	<i>Carrying Value</i>
	<i>Total Fair Value</i>				
<b>Assets</b>					
Senior Secured Loan at:					
September 30, 2018	\$ 55,000	\$	\$ 55,000	\$	\$ 54,345
December 31, 2017	\$	\$	\$	\$	\$
<b>Liabilities</b>					
Debt at:					
September 30, 2018	\$ 468,541	\$	\$ 468,541	\$	\$ 482,654
December 31, 2017	\$ 459,048	\$	\$ 459,048	\$	\$ 461,683

---

**Table of Contents****Note 10. Stockholders Equity**

The Company's authorized capital stock consists of 400,000,000 shares of common stock, \$0.01 par value per share, and 100,000,000 shares of preferred stock, \$0.01 par value per share. The Company has an at-the-market equity offering program (the \$250 Million ATM Program) pursuant to which the Company may issue and sell shares of its common stock having an aggregate offering price of up to \$250.0 million (\$202.9 million remaining as of September 30, 2018) in amounts and at times to be determined by the Company from time to time. Prior to the implementation of the \$250 Million ATM Program, the Company had a \$200.0 million ATM program (the \$200 Million ATM Program), which was substantially utilized as of June 30, 2018 and which is no longer active, and a \$150.0 million ATM program (the \$150 Million ATM Program), which was fully utilized as of June 30, 2017. Actual sales under the \$250 Million ATM Program, if any, will depend on a variety of factors to be determined by the Company from time to time, including, among others, market conditions, the trading price of the Company's common stock, determinations by the Company of the appropriate sources of funding for the Company and potential uses of funding available to the Company. During the three and nine months ended September 30, 2018, the Company issued an aggregate of 729,667 and 3,615,068 shares, respectively, of common stock at a weighted average offering price of \$38.22 and \$37.59 per share, respectively, under the \$250 Million ATM Program and the \$200 Million ATM Program, resulting in net proceeds of approximately \$27.5 million and \$133.9 million, respectively, and paying total compensation to the applicable sales agents of approximately \$0.4 million and \$2.0 million, respectively. During the three and nine months ended September 30, 2017, the Company issued an aggregate of 2,206,685 and 7,042,771 shares, respectively, of common stock at a weighted average offering price of \$35.84 and \$31.87 per share, respectively, under the \$200 Million ATM Program and the \$150 Million ATM Program, resulting in net proceeds of approximately \$77.9 million and \$221.2 million, respectively, and paying total compensation to the applicable sales agents of approximately \$1.1 million and \$3.3 million, respectively.

The Company has a share repurchase program authorizing the Company to repurchase up to 2,000,000 shares of its outstanding common stock from time to time through December 31, 2018. Purchases made pursuant to the program will be made in either the open market or in privately negotiated transactions as permitted by federal securities laws and other legal requirements. The timing, manner, price and amount of any repurchases will be determined by the Company in its discretion and will be subject to economic and market conditions, stock price, applicable legal requirements and other factors. The program may be suspended or discontinued at any time. As of September 30, 2018, the Company has not repurchased any shares of stock pursuant to its share repurchase authorization.

In connection with the Annual Meeting of stockholders on May 1, 2018, the Company granted a total of 9,656 shares of unrestricted common stock to its independent directors under the Company's Amended and Restated 2010 Equity Incentive Plan (the Plan) with a grant date fair value per share of \$37.29. The grant date fair value of the unrestricted common stock was determined using the closing price of the Company's common stock on the date of the grant. The Company recognized approximately \$0.4 million in compensation costs for both the three and nine months ended September 30, 2018 related to this issuance.

On July 19, 2017, the Company redeemed all 1,840,000 outstanding shares of the 7.75% Series A Cumulative Redeemable Preferred Stock (Series A Preferred Stock) for cash at a redemption price of \$25.00 per share, plus an amount per share of \$0.096875 representing all accrued and unpaid dividends per share from July 1, 2017 to, but excluding, July 19, 2017. As of both September 30, 2018 and December 31, 2017, no shares of Series A Preferred Stock were issued and outstanding.

As of September 30, 2018, there were 1,705,000 shares of common stock authorized for issuance as restricted stock grants, unrestricted stock awards or Performance Share awards under the Plan, of which 335,490 were remaining available for issuance. The grant date fair value per share of restricted stock awards issued during the period from

February 16, 2010 (commencement of operations) to September 30, 2018 ranged from \$14.20 to \$37.16. The fair value of the restricted stock that was granted during the nine months ended September 30, 2018 was approximately \$1.9 million and the vesting period for the restricted stock is five years. As of September 30, 2018, the Company had approximately \$5.1 million of total unrecognized compensation costs related to restricted stock issuances, which is expected to be recognized over a remaining weighted average period of approximately 4.2 years. The Company recognized compensation costs of approximately \$0.5 million for both the three months ended September 30, 2018 and 2017, and approximately \$1.4 million for both the nine months ended September 30, 2018 and 2017 related to the restricted stock issuances.

**Table of Contents**

The following is a summary of the total restricted shares granted to the Company's executive officers and employees with the related weighted average grant date fair value share prices for the nine months ended September 30, 2018:

**Restricted Stock Activity:**

	Shares	Weighted Average Grant Date Fair Value
Non-vested shares outstanding as of December 31, 2017	357,183	\$ 21.01
Granted	53,915	34.63
Forfeited	(11,830)	20.30
Vested	(15,338)	20.21
Non-vested shares outstanding as of September 30, 2018	383,930	\$ 22.98

The following is a vesting schedule of the total non-vested shares of restricted stock outstanding as of September 30, 2018:

Non-vested Shares Vesting Schedule	Number of Shares
2018 (3 months)	
2019	24,372
2020	303,433
2021	13,750
2022	10,068
Thereafter	32,307
<b>Total Non-vested Shares</b>	<b>383,930</b>

**Long-Term Incentive Plan:**

As of September 30, 2018, there are three open performance measurement periods for the Performance Share awards: January 1, 2016 to December 31, 2018, January 1, 2017 to December 31, 2019 and January 1, 2018 to December 31, 2020. During the nine months ended September 30, 2018, the Company issued 195,963 shares of common stock at a price of \$34.50 per share related to the Performance Share awards for the performance period from January 1, 2015 to December 31, 2017. The expense related to the open Performance Share awards varies quarter to quarter based on the Company's relative share price performance.

The following table summarizes certain information with respect to the Performance Share awards (dollars in thousands):

<b>Expense</b>	<b>Expense</b>
----------------	----------------

Performance Share Period	Fair Value		Actual		Three Months Ended		Nine Months Ended	
	September 30, 2018	September 30, 2018	September 30, 2018	September 30, 2018	September 30, 2017	September 30, 2018	September 30, 2017	
January 1, 2018 - December 31, 2020	\$ 3,175	\$ 791	\$ 268	\$ 791	\$	\$ 791	\$	
January 1, 2017 - December 31, 2019	5,471	3,188	546	518	1,655	1,193		
January 1, 2016 - December 31, 2018	5,820	5,331	487	633	1,880	1,988		
January 1, 2015 - December 31, 2017				784		2,387		
<b>Total</b>	<b>\$ 14,466</b>	<b>\$ 9,310</b>	<b>\$ 1,301</b>	<b>\$ 1,935</b>	<b>\$ 4,326</b>	<b>\$ 5,568</b>		

**Dividends:**

The following table sets forth the cash dividends paid or payable per share during the nine months ended September 30, 2018:

**For the Three Months**

Ended	Dividend per					
	Security	Share	Declaration Date	Record Date	Date Paid	
March 31, 2018	Common stock	\$ 0.22	February 6, 2018	March 28, 2018	April 12, 2018	
June 30, 2018	Common stock	\$ 0.22	May 1, 2018	July 6, 2018	July 20, 2018	
September 30, 2018	Common stock	\$ 0.24	August 1, 2018	October 5, 2018	October 19, 2018	



**Table of Contents****Note 11. Net Income (Loss) Per Share**

Pursuant to ASC 260-10-45, *Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities*, unvested share-based payment awards that contain non-forfeitable rights to dividends are participating securities and are included in the computation of earnings per share pursuant to the two-class method. The two-class method of computing earnings per share allocates earnings per share for common stock and any participating securities according to dividends declared (whether paid or unpaid) and participation rights in undistributed earnings. Under the two-class method, earnings per common share are computed by dividing the sum of distributed earnings to common stockholders and undistributed earnings allocated to common stockholders by the weighted average number of common shares outstanding for the period. The Company's non-vested shares of restricted stock are considered participating securities since these share-based awards contain non-forfeitable rights to dividends irrespective of whether the awards ultimately vest or expire. The Company had no dilutive restricted stock awards outstanding for both the three and nine months ended September 30, 2018 and 2017.

In accordance with the Company's policies of determining whether instruments granted in share-based payment transactions are participating securities and accounting for earnings per share, the net income (loss) per common share is adjusted for earnings distributed through declared dividends (if any) and allocated to all participating securities (weighted average common shares outstanding and unvested restricted shares outstanding) under the two-class method. Under this method, allocations were made to 374,862 and 374,842 of weighted average unvested restricted shares outstanding for the three months ended September 30, 2018 and 2017, respectively, and 363,850 and 381,321 of weighted average unvested restricted shares outstanding for the nine months ended September 30, 2018 and 2017, respectively.

**Note 12. Commitments and Contingencies**

**Contractual Commitments.** As of November 1, 2018, the Company has two outstanding contracts with third-party sellers to acquire two industrial properties consisting of approximately 60,000 square feet and one improved land parcel containing approximately 2.3 acres. There is no assurance that the Company will acquire the properties under contract because the proposed acquisitions are subject to the completion of satisfactory due diligence and various closing conditions.

The following table summarizes certain information with respect to the properties the Company has under contract:

Market	Number of Buildings	Square Feet	Purchase Price (in thousands)	Assumed Debt (in thousands)
Los Angeles <sup>1</sup>	1	60,040	\$ 17,508	\$
Northern New Jersey/New York City				
San Francisco Bay Area				
Seattle				
Miami				
Washington, D.C.				
<b>Total</b>	<b>1</b>	<b>60,040</b>	<b>\$ 17,508</b>	<b>\$</b>

<sup>1</sup> Includes one improved land parcel containing approximately 2.3 acres.

As of November 1, 2018, the Company has executed four non-binding letters of intent with third-party sellers to acquire four industrial properties consisting of approximately 37,000 square feet and two improved land parcels containing approximately 24.3 acres. The total anticipated purchase price for these industrial properties is approximately \$51.0 million. In the normal course of its business, the Company enters into non-binding letters of intent to purchase properties from third parties that may obligate the Company to make payments or perform other obligations upon the occurrence of certain events, including the execution of a purchase and sale agreement and satisfactory completion of various due diligence matters. There can be no assurance that the Company will enter into purchase and sale agreements with respect to these properties or otherwise complete any such prospective purchases on the terms described or at all.

As of November 1, 2018, the Company has two outstanding contracts with third-party purchasers to sell two properties for an aggregate sales price of approximately \$38.8 million (aggregate net book value of approximately \$23.0 million). There is no assurance the Company will sell the properties under contract because the proposed dispositions are subject to the purchaser's completion of satisfactory due diligence and various closing conditions.

**Table of Contents**

**Note 13. Subsequent Events**

On October 17, 2018, the Company acquired one industrial building located in Carlstadt, New Jersey containing approximately 24,000 square feet for a purchase price of approximately \$3.5 million. The property was acquired from an unrelated third party using existing cash on hand.

On October 19, 2018, the Company entered into a Fifth Amended and Restated Senior Credit Agreement to, among other things, increase the unsecured revolving credit facility from \$200.0 million to \$250.0 million and extend the revolving credit facility's maturity to October 2022 (previously August 2020).

On October 24, 2018, the Company acquired one improved land parcel located in Kent, Washington containing approximately 12.7 acres for a total purchase price of approximately \$12.4 million. The property is under redevelopment and upon completion will contain approximately 220,000 square feet with a total expected investment of approximately \$33.9 million, including redevelopment costs of approximately \$21.1 million. The property was acquired from an unrelated third party using proceeds from borrowings on the Company's revolving credit facility.

On October 31, 2018, the Company's board of directors approved an extension of the share repurchase program authorizing the Company to repurchase up to 3,000,000 shares (previously 2,000,000 shares) of its outstanding common stock from time to time through December 31, 2020.

On October 31, 2018, the Company's board of directors declared a cash dividend in the amount of \$0.24 per share of its common stock payable on January 11, 2019 to the stockholders of record as of the close of business on December 18, 2018.

On October 31, 2018, the Company acquired one industrial building located in Seattle, Washington for a total purchase price of approximately \$12.6 million. The property is under redevelopment and upon completion will contain approximately 50,000 square feet with a total expected investment of approximately \$15.3 million, including redevelopment costs of approximately \$2.6 million. The property was acquired from an unrelated third party using proceeds from borrowings on the Company's revolving credit facility.

---

**Table of Contents**

**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.**

This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, Section 27A of the Securities Act of 1933, as amended (the "Securities Act") and Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). We caution investors that forward-looking statements are based on management's beliefs and on assumptions made by, and information currently available to, management. When used, the words "anticipate", "believe", "estimate", "expect", "intend", "may", "might", "project", "result", "should", "will", "seek", "target", "see", "likely", "position", "opportunity", "outlook" and similar not relate solely to historical matters are intended to identify forward-looking statements. These statements are subject to risks, uncertainties, and assumptions and are not guarantees of future performance, which may be affected by known and unknown risks, trends, uncertainties, and factors that are beyond our control. Should one or more of these risks or uncertainties materialize, or should underlying assumptions prove incorrect, actual results may vary materially from those anticipated, estimated, or projected. We expressly disclaim any responsibility to update our forward-looking statements, whether as a result of new information, future events, or otherwise, except as required by law. Accordingly, investors should use caution in relying on past forward-looking statements, which are based on results and trends at the time they are made, to anticipate future results or trends.

Some of the risks and uncertainties that may cause our actual results, performance, or achievements to differ materially from those expressed or implied by forward-looking statements include, among others, the following:

the factors included under the headings "Risk Factors" and "Management's Discussion and Analysis of Financial Condition and Results of Operations" in our Annual Report on Form 10-K for the year ended December 31, 2017, which was filed with the Securities and Exchange Commission on February 7, 2018 and in our other public filings;

our ability to identify and acquire industrial properties on terms favorable to us;

general volatility of the capital markets and the market price of our common stock;

adverse economic or real estate conditions or developments in the industrial real estate sector and/or in the markets in which we acquire properties;

our dependence on key personnel and our reliance on third-party property managers;

our inability to comply with the laws, rules and regulations applicable to companies, and in particular, public companies;

our ability to manage our growth effectively;

tenant bankruptcies and defaults on or non-renewal of leases by tenants;

decreased rental rates or increased vacancy rates;

increased interest rates and operating costs;

declining real estate valuations and impairment charges;

our expected leverage, our failure to obtain necessary outside financing, and future debt service obligations;

our ability to make distributions to our stockholders;

our failure to successfully hedge against interest rate increases;

our failure to successfully operate acquired properties;

risks relating to our real estate redevelopment, renovation and expansion strategies and activities;

**Table of Contents**

our failure to qualify or maintain our status as a real estate investment trust ( REIT ), and possible adverse changes to tax laws;

uninsured or underinsured losses and costs relating to our properties or that otherwise result from future litigation;

environmental uncertainties and risks related to natural disasters;

financial market fluctuations; and

changes in real estate and zoning laws and increases in real property tax rates.

**Overview**

Terreno Realty Corporation ( Terreno , and together with its subsidiaries, we , us , our , our Company , or the Company ) acquires, owns and operates industrial real estate in six major coastal U.S. markets: Los Angeles, Northern New Jersey/New York City, San Francisco Bay Area, Seattle, Miami, and Washington, D.C. We invest in several types of industrial real estate, including warehouse/distribution, flex (including light industrial and research and development, or R&D) and transshipment. We target functional buildings in infill locations that may be shared by multiple tenants and that cater to customer demand within the various submarkets in which we operate. Infill locations are geographic locations surrounded by high concentrations of already developed land and existing buildings. As of September 30, 2018, we owned a total of 203 buildings (including one building held for sale) aggregating approximately 12.9 million square feet that were approximately 98.5% leased to 452 customers, the largest of which accounted for approximately 4.0% of our total annualized base rent, 13 improved land parcels consisting of approximately 52.9 acres and four buildings under redevelopment expected to contain approximately 0.5 million square feet upon completion. We are an internally managed Maryland corporation and elected to be taxed as a REIT under Sections 856 through 860 of the Internal Revenue Code of 1986, as amended, or the Code, commencing with our taxable year ended December 31, 2010.

The following table summarizes by market our investments in real estate as of September 30, 2018:

Market	Number of Rentable Buildings	Square Feet	% of Total	Occupancy as of September 30, 2018	Annualized Base Rent (000 \$)	% of Total	Weighted		Gross Book Value (000 \$)
							Annualized Base Rent per Square Foot	Average Remaining Lease Term (Years) <sup>2</sup>	
Los Angeles	36	2,736,305	21.2%	98.9%	\$ 21,103	18.7%	\$ 7.79	6.9	\$ 391,653
Northern New Jersey/New York City	55	3,145,507	24.4%	99.4%	27,707	24.5%	8.86	4.0	450,255
San Francisco Bay Area	36	1,787,422	13.8%	96.6%	19,072	16.9%	11.04	3.9	279,875
Seattle	25	1,665,625	12.9%	99.4%	13,459	11.9%	8.13	3.7	233,673

Edgar Filing: Terreno Realty Corp - Form 10-Q

Miami <sup>4</sup>	28	1,522,904	11.8%	98.0%	12,625	11.2%	8.46	3.6	176,450
Washington, D.C.	23	2,059,480	15.9%	97.7%	18,972	16.8%	9.43	4.0	268,782
Total/Weighted Average	203	12,917,243	100.0%	98.5%	\$ 112,938	100.0%	\$ 8.88	4.5	\$ 1,800,688

- <sup>1</sup> Annualized base rent is calculated as contractual monthly base rent per the leases, excluding any partial or full rent abatements, as of September 30, 2018, multiplied by 12.
- <sup>2</sup> Weighted average remaining lease term is calculated by summing the remaining lease term of each lease as of September 30, 2018, weighted by the respective square footage.
- <sup>3</sup> Includes approximately 52.9 acres of improved land and four buildings under redevelopment expected to contain approximately 0.5 million square feet upon completion as discussed below.
- <sup>4</sup> Includes one building held for sale with a gross book value of approximately \$3.2 million and accumulated depreciation and amortization of approximately \$0.7 million as of September 30, 2018.

As of September 30, 2018, we owned 13 improved land parcels totaling approximately 52.9 acres that were approximately 73.6% leased to 14 customers. Such land is used for truck, trailer and container storage and/or car parking. In the future, we may redevelop such land. As of September 30, 2018, we own four buildings under redevelopment expected to contain approximately 0.5 million square feet upon completion with a total expected investment of approximately \$119.0 million, including redevelopment costs of approximately \$32.7 million.

**Table of Contents**

The following table summarizes by market our investments in improved land as of September 30, 2018:

Market	Number of Parcels	Acres	Occupancy %		Annualized Base Rent (000 s)	% of Total	Annualized Base Rent Per Weighted Average Occupied Square Foot Remaining Lease Term (Years) <sup>2</sup>	
			% of Total	as of September 30, 2018			Foot	Term (Years) <sup>2</sup>
Los Angeles	3	8.0	15.1%	57.6%	\$ 727	17.9%	\$ 3.61	1.4
Northern New Jersey/New York City	5	26.9	50.9%	60.7%	2,053	50.7%	2.89	7.1
San Francisco Bay Area	2	1.4	2.6%	100.0%	202	5.0%	3.21	1.6
Seattle								
Miami	2	3.2	6.1%	100.0%	335	8.3%	2.43	0.6
Washington, D.C.	1	13.4	25.3%	100.0%	734	18.1%	1.26	1.3
Total/Weighted Average	13	52.9	100.0%	73.6%	\$ 4,051	100.0%	\$ 2.39	3.7

<sup>1</sup> Annualized base rent is calculated as contractual monthly base rent per the leases, excluding any partial or full rent abatements, as of September 30, 2018, multiplied by 12.

<sup>2</sup> Weighted average remaining lease term is calculated by summing the remaining lease term of each lease as of September 30, 2018, weighted by the respective square footage.

The following table summarizes our capital expenditures incurred during the three and nine months ended September 30, 2018 and 2017 (dollars in thousands):

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2018	2017	2018	2017
Building improvements	\$ 3,350	\$ 2,866	\$ 11,098	\$ 8,884
Tenant improvements	354	1,623	1,976	4,936
Leasing commissions	2,053	1,464	4,763	4,747
Redevelopment, renovation and expansion	2,718		5,613	
Total capital expenditures <sup>1</sup>	\$ 8,475	\$ 5,953	\$ 23,450	\$ 18,567

<sup>1</sup> Includes approximately \$5.6 million and \$3.1 million for the three months ended September 30, 2018 and 2017, respectively, and approximately \$13.8 million and \$9.6 million for the nine months ended September 30, 2018 and 2017, respectively, related to leasing acquired vacancy, redevelopment construction in progress and renovation and expansion projects (stabilization capital) at 11 and nine properties for the three months ended



## Edgar Filing: Terreno Realty Corp - Form 10-Q

September 30, 2018 and 2017, respectively, and at 17 and 13 properties for the nine months ended September 30, 2018 and 2017, respectively.

Our industrial properties are typically subject to leases on a triple net basis, in which tenants pay their proportionate share of real estate taxes, insurance and operating costs, or are subject to leases on a modified gross basis, in which tenants pay expenses over certain threshold levels. In addition, approximately 92.1% of our leased space includes fixed rental increases or Consumer Price Index-based rental increases. Lease terms typically range from three to ten years. We monitor the liquidity and creditworthiness of our tenants on an on-going basis by reviewing outstanding accounts receivable balances, and as provided under the respective lease agreements, review the tenant's financial condition periodically as appropriate. As needed, we hold discussions with the tenant's management about their business and we conduct site visits of the tenant's operations.

**Table of Contents**

Our top 20 customers based on annualized base rent as of September 30, 2018 are as follows:

Customer	Leases	Rentable Square Feet	% of Total Rentable Square Feet	Annualized Base Rent (000 \$)	% of Total Annualized Base Rent
1 United States Government	9	381,431	3.0%	\$ 4,696	4.0%
2 FedEx Corporation	7	490,779	3.7%	4,607	3.9%
3 Danaher	3	171,707	1.3%	2,961	2.5%
4 Northrop Grumman Systems	2	199,866	1.5%	2,270	1.9%
5 AmerisourceBergen	1	211,418	1.6%	2,260	1.9%
6 District of Columbia	3	149,203	1.2%	1,600	1.4%
7 Z Gallerie Inc.	1	230,891	1.8%	1,512	1.3%
8 XPO Logistics	2	180,717	1.4%	1,497	1.3%
9 West Coast Warehouse Inc.	1	265,500	2.1%	1,468	1.3%
10 YRC	2	61,252	0.5%	1,337	1.1%
11 O Neill Logistics	2	237,692	1.8%	1,323	1.1%
12 Miami International Freight Systems	1	192,454	1.5%	1,245	1.1%
13 Bar Logistics	2	203,263	1.6%	1,220	1.0%
14 Saia Motor Freight Line LLC	1	52,086	0.4%	1,212	1.0%
15 L-3 Communications Corporation	1	135,579	1.0%	1,180	1.0%
16 JAM N Logistics	1	110,336	0.9%	1,159	1.0%
17 Avborne Accessory Group	2	137,594	1.1%	1,135	1.0%
18 Space Systems/Loral LLC	2	107,060	0.8%	1,107	1.0%
19 Amazon.com	1	158,168	1.2%	1,044	0.9%
20 Exquisite Apparel Corporation	1	114,061	0.9%	985	0.9%
<b>Total</b>	<b>45</b>	<b>3,791,057</b>	<b>29.3%</b>	<b>\$ 35,818</b>	<b>30.6%</b>

<sup>1</sup> Annualized base rent is calculated as contractual monthly base rent per the leases, excluding any partial or full rent abatements, as of September 30, 2018, multiplied by 12.

The following table summarizes the anticipated lease expirations for leases in place as of September 30, 2018, without giving effect to the exercise of unexercised renewal options or termination rights, if any, at or prior to the scheduled expirations:

Year	Rentable Square Feet	% of Total Rentable Square Feet	Annualized Base Rent (000 \$)	% of Total Annualized Base Rent
2018 (3 months) <sup>1</sup>	153,612	1.2%	\$ 1,548	1.2%
2019	1,919,111	14.9%	14,748	11.6%
2020	1,906,417	14.8%	18,187	14.3%
2021	2,343,186	18.1%	20,688	16.3%
2022	1,668,305	12.9%	16,376	12.9%
Thereafter	4,729,991	36.6%	55,289	43.7%

Total	12,720,622	98.5%	\$	126,836	100.0%
-------	------------	-------	----	---------	--------

<sup>1</sup> Includes leases that expire on or after September 30, 2018 and month-to-month leases totaling approximately 75,000 square feet.

<sup>2</sup> Annualized base rent is calculated as contractual monthly base rent per the leases at expiration, excluding any partial or full rent abatements, as of September 30, 2018, multiplied by 12.

Our ability to re-lease or renew expiring space at rental rates equal to or in excess of current rental rates will impact our results of operations. As of September 30, 2018, leases representing approximately 12.8% of the total rentable square footage of our portfolio are scheduled to expire through December 31, 2019. We currently expect that, on average, the rental rates we are likely to achieve on new (re-leased) or renewed leases for 2018 and 2019 expirations will be above the rates currently being paid for the same space. The tenant at our Belleville property received approximately \$0.6 million in rent abatements during the nine months ended September 30, 2018 under the terms of a previously negotiated ten-year lease extension. Rent changes on new and renewed leases totaling approximately 0.3 million square feet commencing during the three months ended September 30, 2018 were approximately 13.4% higher as compared to the previous rental rates for that same space, and rent changes on new and renewed leases totaling approximately 1.2 million square feet commencing during the nine months ended September 30, 2018 were approximately 17.5% higher as compared to the previous rental rates for that same space. Our past performance may not be indicative of future results, and we cannot assure you that leases will be renewed or that our properties will be re-leased at all or at rental rates equal to or above the current average rental rates. Further, re-leased/renewed rental rates in a particular market may not be consistent with rental rates across our portfolio as a whole and re-leased/renewed rental rates for particular properties within a market may not be consistent with rental rates across our portfolio within a particular market, in each case due to a number of factors, including local real estate conditions, local supply and demand for industrial space, the condition of the property, the impact of leasing incentives, including free rent and tenant improvements and whether the property, or space within the property, has been redeveloped.

**Table of Contents****Recent Developments*****Acquisition Activity***

During the three months ended September 30, 2018, we acquired eight industrial buildings containing approximately 407,000 square feet and two improved land parcels containing approximately 1.4 acres for a total purchase price of approximately \$67.8 million. The properties were acquired from unrelated third parties using existing cash on hand, net proceeds from dispositions, net proceeds from the issuance of common stock and proceeds from borrowings on our revolving credit facility. The following table sets forth the industrial properties we acquired during the three months ended September 30, 2018:

<b>Property Name</b>	<b>Location</b>	<b>Acquisition Date</b>	<b>Number of Buildings</b>	<b>Square Feet</b>	<b>Purchase Price (in thousands)</b>	<b>Stabilized Cap Rate<sup>2</sup></b>
Merced <sup>3</sup>	San Leandro, CA	August 2, 2018	4	225,344	\$ 36,000	5.2%
San Clemente	Hayward, CA	September 7, 2018	1	54,000	9,000	4.6%
Whitney <sup>4</sup>	San Leandro, CA	September 17, 2018	3	128,073	22,790	4.8%
Total/Weighted Average			8	407,417	\$ 67,790	5.0%

<sup>1</sup> Excludes intangible liabilities and mortgage premiums, if any. The total aggregate investment was approximately \$70.4 million, including \$0.7 million in closing costs and acquisition costs.

<sup>2</sup> Stabilized cap rates are calculated, at the time of acquisition, as annualized cash basis net operating income for the property stabilized to market occupancy (generally 95%) divided by the total acquisition cost for the property. Total acquisition cost basis for the property includes the initial purchase price, the effects of marking assumed debt to market, buyer's due diligence and closing costs, estimated near-term capital expenditures and leasing costs necessary to achieve stabilization. We define cash basis net operating income for the property as net operating income excluding straight-line rents and amortization of lease intangibles. These stabilized cap rates are subject to risks, uncertainties, and assumptions and are not guarantees of future performance, which may be affected by known and unknown risks, trends, uncertainties, and factors that are beyond our control, including risks related to our ability to meet our estimated forecasts related to stabilized cap rates and those risk factors contained in our Annual Report on Form 10-K for the year ended December 31, 2017.

<sup>3</sup> Also includes one improved land parcel totaling approximately 1.2 acres.

<sup>4</sup> Also includes one improved land parcel totaling approximately 0.2 acres.

Subsequent to September 30, 2018, we acquired two industrial buildings and one improved land parcel for a total purchase price of approximately \$28.5 million. The properties were acquired from unrelated third parties using existing cash on hand and proceeds from borrowings on our revolving credit facility. The following table sets forth the industrial properties we acquired subsequent to September 30, 2018:

<b>Property Name</b>	<b>Location</b>	<b>Acquisition Date</b>	<b>Number of Buildings</b>	<b>Square Feet</b>	<b>Purchase Price (in thousands)</b>	<b>Stabilized Cap Rate</b>
130 Commerce	Carlstadt, NJ	October 17, 2018	1	24,000	\$ 3,480	5.2%
DC 192 <sup>1</sup>	Kent, WA	October 24, 2018			12,434	5.6%

Edgar Filing: Terreno Realty Corp - Form 10-Q

2200 6th Ave S <sup>2</sup>	Seattle, WA	October 31, 2018	1	50,270	12,558	5.1%
Total/Weighted Average			2	74,270	\$ 28,472	5.3%

- <sup>1</sup> Includes one improved land parcel under redevelopment containing approximately 12.7 acres, which upon completion will contain approximately 220,000 square feet with a total expected investment of approximately \$33.9 million, including redevelopment costs of approximately \$21.1 million.
- <sup>2</sup> Includes one building under redevelopment which upon completion will contain approximately 50,000 square feet with a total expected investment of approximately \$15.3 million, including redevelopment costs of approximately \$2.6 million.

**Table of Contents****Redevelopment Activity**

In 2018, we began redevelopment of four buildings that will contain approximately 0.5 million square feet upon completion with a total expected investment of approximately \$119.0 million, including redevelopment costs, capitalized interest and other costs of approximately \$32.7 million as follows:

Property Name	Total Expected Investment (in thousands) <sup>1</sup>		Estimated Amount Spent	Estimated Remaining to Stabilized Cap	Estimated Completion Quarter
		Date	Spend	Rate <sup>2</sup>	
1775 NW 70th Avenue	\$ 10,198	\$ 9,802	\$ 396	5.3%	Q1 2019
Woodside	31,910	26,829	5,081	6.3%	Q4 2018
1st Avenue South	63,675	44,372	19,303	5.1%	Q3 2020
10100 NW 25th Street	13,231	10,052	3,179	5.3%	Q1 2019
Total/Weighted Average	\$ 119,014	\$ 91,055	\$ 27,959	5.5%	

<sup>1</sup> Total expected investment for the property includes the initial purchase price, buyer's due diligence and closing costs, estimated near-term redevelopment expenditures, capitalized interest and leasing costs necessary to achieve stabilization.

<sup>2</sup> Estimated stabilized cap rates are calculated as annualized cash basis net operating income for the property stabilized to market occupancy (generally 95%) divided by the total acquisition cost for the property. We define cash basis net operating income for the property as net operating income excluding straight-line rents and amortization of lease intangibles. These estimated stabilized cap rates are subject to risks, uncertainties, and assumptions and are not guarantees of future performance, which may be affected by known and unknown risks, trends, uncertainties, and factors that are beyond our control, including risks related to our ability to meet our estimated forecasts related to stabilized cap rates and those risk factors contained in our Annual Report on Form 10-K for the year ended December 31, 2017.

**Disposition Activity**

During the nine months ended September 30, 2018, we sold one property located in the Washington, D.C. market for a sales price of approximately \$20.3 million, resulting in a gain of approximately \$3.3 million, and one property located in the Miami market for a sales price of approximately \$24.3 million, resulting in a gain of approximately \$11.7 million.

The following summarizes the condensed results of operations of the properties sold during the nine months ended September 30, 2018, for the three and nine months ended September 30, 2018 and 2017 (dollars in thousands):

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2018	2017	2018	2017
Rental revenues	\$ 15	\$ 525	\$ 820	\$ 1,768
Tenant expense reimbursements	15	51	33	159

Edgar Filing: Terreno Realty Corp - Form 10-Q

Property operating expenses	(184)	(257)	(478)
Depreciation and amortization	(164)	(182)	(589)
Income from operations	\$ 15	\$ 228	\$ 414
			\$ 860

***ATM Program***

We have an at-the-market equity offering program (the \$250 Million ATM Program ) pursuant to which we may issue and sell shares of our common stock having an aggregate offering price of up to \$250.0 million (\$202.9 million remaining as of September 30, 2018) in amounts and at times as we determine from time to time. Prior to the implementation of the \$250 Million ATM Program, we had a \$200.0 million ATM Program (the \$200 Million ATM Program ) which was substantially utilized as of June 30, 2018 and which is no longer active, and a \$150.0 million ATM program, which was fully utilized as of June 30, 2017. We intend to use the net proceeds from the offering of the shares under the \$250 Million ATM Program, if any, for general corporate purposes, which may include future acquisitions and repayment of indebtedness, including borrowings under our revolving credit facility. During the three and nine months ended September 30, 2018, we issued an aggregate of 729,667 and 3,615,068 shares, respectively, of common stock at a weighted average offering price of \$38.22 and \$37.59 per share, respectively, under the \$250 Million ATM Program and the \$200 Million ATM Program, resulting in net proceeds of approximately \$27.5 million and \$133.9 million, respectively, and paying total compensation to the applicable sales agents of approximately \$0.4 million and \$2.0 million, respectively.

## **Table of Contents**

### ***Senior Secured Loan***

On May 7, 2018, we made a senior secured loan of \$55.0 million with a two-year term that bears interest at a fixed annual interest rate of 8.0% and matures in May 2020 (the Senior Secured Loan). The Senior Secured Loan is secured by a portfolio of nine improved land parcels primarily located in Newark and Kearny, New Jersey. One of the properties securing the Senior Secured Loan may be put to us as partial repayment of the Senior Secured Loan. This property, and two of the other properties, may be called by us as partial or full repayment of the Senior Secured Loan at previously agreed upon values. In addition, per the terms of the Senior Secured Loan, the borrower may repay the loan at any time with either cash or deeds in lieu, with the deeds subject to our approval. As of September 30, 2018, the borrower has offered repayment with deeds in lieu on two of the three option properties for an aggregate purchase price of approximately \$39.1 million. As of November 1, 2018, we have entered into two non-binding letters of intent to acquire two of the three option properties for approximately \$39.1 million. In the normal course of our business, we enter into non-binding letters of intent to purchase properties from third parties that may obligate us to make payments or perform other obligations upon the occurrence of certain events, including the execution of a purchase and sale agreement and satisfactory completion of various due diligence matters. There can be no assurance that we will enter into purchase and sale agreements with respect to these properties or otherwise complete any such prospective purchases on the terms described or at all. As of September 30, 2018 and December 31, 2017, there was approximately \$54.3 million and \$0, respectively, net of deferred loan fees of approximately \$0.7 million and \$0, respectively, outstanding on the Senior Secured Loan and approximately \$0.4 million and \$0, respectively, of interest receivable outstanding on the Senior Secured Loan.

### ***Share Repurchase Program***

On October 31, 2018, our board of directors approved an extension of the share repurchase program authorizing us to repurchase up to 3,000,000 shares (previously 2,000,000 shares) of our outstanding common stock from time to time through December 31, 2020. Purchases made pursuant to the program, if any, will be made in either the open market or in privately negotiated transactions as permitted by federal securities laws and other legal requirements. The timing, manner, price and amount of any repurchases will be determined by us in our discretion and will be subject to economic and market conditions, stock price, applicable legal requirements and other factors. The program may be suspended or discontinued at any time. As of September 30, 2018, we have not repurchased any shares of stock pursuant to our share repurchase authorization.

### ***Dividend and Distribution Activity***

On October 31, 2018, our board of directors declared a cash dividend in the amount of \$0.24 per share of our common stock payable on January 11, 2019 to the stockholders of record as of the close of business on December 18, 2018.

### ***Contractual Commitments***

As of November 1, 2018, we have two outstanding contracts with third-party sellers to acquire two industrial properties, four non-binding letters of intent with third-party sellers to acquire four industrial properties and two outstanding contracts with third-party purchasers to sell two properties as described under the heading Contractual Obligations in this Quarterly Report on Form 10-Q. There is no assurance that we will acquire or sell the properties under contract because the proposed acquisitions and dispositions are subject to the completion of satisfactory due diligence and various closing conditions, and with respect to the properties under non-binding letters of intent, our entry into purchase and sale agreements.

### ***Supplemental Material U.S. Federal Income Tax Considerations***



Edgar Filing: Terreno Realty Corp - Form 10-Q

The following discussion updates the disclosures under Material U.S. Federal Income Tax Considerations in the prospectus dated February 9, 2018 contained in our Registration Statement on Form S-3 filed with the SEC on February 9, 2018 and contained in the prospectus supplement dated May 31, 2018.

---

**Table of Contents**

On March 23, 2018, President Donald J. Trump signed into law the Consolidated Appropriations Act, 2018 (the CAA ), which amended various provisions of the Code and implicate certain tax-related disclosures contained in the prospectus. As a result, the discussion in the third and fourth paragraphs under Material U.S. Federal Income Tax Considerations-U.S. Taxation of Non-U.S. Stockholders-Sale of Stock on pages 33 to 35 of the prospectus is replaced with the following paragraphs:

Additionally, to the extent our stock is held directly (or indirectly through one or more partnerships) by a qualified shareholder, it will not be treated as a U.S. real property interest for such qualified shareholder. Further, to the extent such treatment applies, any distribution to such shareholder will not be treated as gain recognized from the sale or exchange of a U.S. real property interest. For these purposes, a qualified shareholder is generally a non-U.S. stockholder that (i)(A) is eligible for treaty benefits under an income tax treaty with the United States that includes an exchange of information program, and the principal class of interests of which is listed and regularly traded on one or more stock exchanges as defined by the treaty, or (B) is a foreign limited partnership organized in a jurisdiction with an exchange of information agreement with the United States and that has a class of regularly traded limited partnership units (having a value greater than 50% of the value of all partnership units) on the New York Stock Exchange or Nasdaq, (ii) is a qualified collective investment vehicle (within the meaning of section 897(k)(3)(B) of the Code) and (iii) maintains records of persons holding 5% or more of the class of interests described in clauses (i)(A) or (i)(B) above. However, in the case of a qualified shareholder having one or more applicable investors, the exception described in the first sentence of this paragraph will not apply to the applicable percentage of the qualified shareholder's stock (where applicable percentage generally means the percentage of the value of the interests in the qualified shareholder held by applicable investors after applying certain constructive ownership rules). The applicable percentage of the amount realized by a qualified shareholder on the disposition of our stock or with respect to a distribution from us attributable to gain from the sale or exchange of a U.S. real property interest will be treated as amounts realized from the disposition of U.S. real property interest. Such treatment shall also apply to applicable investors in respect of distributions treated as a sale or exchange of stock with respect to a qualified shareholder. For these purposes, an applicable investor is a person who holds an interest in the qualified shareholder and holds more than 10% of our stock applying certain constructive ownership rules.

For FIRPTA purposes a qualified foreign pension fund shall not be treated as a non-U.S. stockholder, and any entity all of the interests of which are held by a qualified foreign pension fund shall be treated as such a fund. A qualified foreign pension fund is an organization or arrangement (i) created or organized in a foreign country, (ii) established to provide retirement or pension benefits to current or former employees (including self-employed individuals) or their designees by either (A) a foreign country as a result of services rendered by such employees to their employers, or (B) one or more employers in consideration for services rendered by such employees to such employers, (iii) which does not have a single participant or beneficiary that has a right to more than 5% of its assets or income, (iv) which is subject to government regulation and with respect to which annual information about its beneficiaries is provided, or is otherwise made available, to relevant local tax authorities and (v) with respect to which, under its local laws, (A) contributions that would otherwise be subject to tax are deductible or excluded from its gross income or taxed at a reduced rate, or (B) taxation of its investment income is deferred, or such income is excluded from its gross income or taxed at a reduced rate.

Finally, the Consolidated Appropriations Act, 2018 clarified that for purposes of determining whether a REIT is a domestically controlled qualified investment entity under FIRPTA, the presumption that generally a person holding less than 5% of a REIT's class of stock that is regularly traded on an established securities market in the United States for five years has been, and will be, treated as a U.S. person applies for testing periods ending on or after December 18, 2015 (e.g., if a testing period ends on June 1, 2018, then the presumption applies for the entire five-year period starting on June 1, 2013).

## Financial Condition and Results of Operations

We derive substantially all of our revenues from rents received from tenants under existing leases on each of our properties. These revenues include fixed base rents and recoveries of certain property operating expenses that we have incurred and that we pass through to the individual tenants. Approximately 92.1% of our leased space includes fixed rental increases or Consumer Price Index-based rental increases. Lease terms typically range from three to ten years.

Our primary cash expenses consist of our property operating expenses, which include: real estate taxes, repairs and maintenance, management expenses, insurance, utilities, general and administrative expenses, which include compensation costs, office expenses, professional fees and other administrative expenses, acquisition costs, which include third-party costs paid to brokers and consultants, and interest expense, primarily on our mortgage loans, revolving credit facility, term loans and senior unsecured notes.

Our consolidated results of operations often are not comparable from period to period due to the impact of property acquisitions at various times during the course of such periods. The results of operations of any acquired property are included in our financial statements as of the date of its acquisition.

The analysis of our results below for the three and nine months ended September 30, 2018 and 2017 includes the changes attributable to same store properties. The same store pool for the comparison of the three and nine months ended September 30, 2018 and 2017 includes all properties that were owned and in operation as of September 30, 2018 and since January 1, 2017 and excludes properties that were either disposed of prior to, held for sale to a third party or in redevelopment as of September 30, 2018. As of September 30, 2018, the same store pool consisted of 157 buildings aggregating approximately 10.7 million square feet representing approximately 82.7% of our total square feet owned and five improved land parcels consisting of 22.8 acres. As of September 30, 2018, the non-same store properties, which we acquired, redeveloped, or sold during 2017 and 2018 or were held for sale (if any) or in redevelopment as of September 30, 2018, consisted of 46 buildings aggregating approximately 2.2 million square feet, eight improved land parcels consisting of 30.1 acres and four buildings under redevelopment expected to contain approximately 0.5 million square feet upon completion. As of September 30, 2018 and 2017, our consolidated same store pool occupancy was approximately 98.9% and 97.4%, respectively.

**Table of Contents**

Our future financial condition and results of operations, including rental revenues, straight-line rents and amortization of lease intangibles, may be impacted by the acquisitions of additional properties, and expenses may vary materially from historical results.

**Comparison of the Three Months Ended September 30, 2018 to the Three Months Ended September 30, 2017:**

	<b>For the Three Months Ended September 30,</b>			
	<b>2018</b>	<b>2017</b>	<b>\$ Change</b>	<b>% Change</b>
	<b>(Dollars in thousands)</b>			
<b>Rental revenues</b>				
Same store	\$ 24,236	\$ 23,113	\$ 1,123	4.9%
Non-same store operating properties <sup>1</sup>	5,466	3,339	2,127	63.7%
<b>Total rental revenues</b>	<b>29,702</b>	<b>26,452</b>	<b>3,250</b>	<b>12.3%</b>
<b>Tenant expense reimbursements</b>				
Same store	7,021	6,453	568	8.8%
Non-same store operating properties <sup>1</sup>	1,176	735	441	60.0%
<b>Total tenant expense reimbursements</b>	<b>8,197</b>	<b>7,188</b>	<b>1,009</b>	<b>14.0%</b>
<b>Total revenues</b>	<b>37,899</b>	<b>33,640</b>	<b>4,259</b>	<b>12.7%</b>
<b>Property operating expenses</b>				
Same store	7,824	7,849	(25)	(0.3)%
Non-same store operating properties <sup>1</sup>	1,662	1,174	488	41.6%
<b>Total property operating expenses</b>	<b>9,486</b>	<b>9,023</b>	<b>463</b>	<b>5.1%</b>
<b>Net operating income <sup>2</sup></b>				
Same store	23,433	21,717	1,716	7.9%
Non-same store operating properties <sup>1</sup>	4,980	2,900	2,080	71.7%
<b>Total net operating income</b>	<b>\$ 28,413</b>	<b>\$ 24,617</b>	<b>\$ 3,796</b>	<b>15.4%</b>
<b>Other costs and expenses</b>				
Depreciation and amortization	10,057	9,595	462	4.8%
General and administrative	5,047	5,041	6	0.1%
Acquisition costs	122		122	n/a
<b>Total other costs and expenses</b>	<b>15,226</b>	<b>14,636</b>	<b>590</b>	<b>4.0%</b>
<b>Other income (expense)</b>				
Interest and other income	1,341	17	1,324	7788.2%
Interest expense, including amortization	(4,406)	(4,514)	108	(2.4)%
Gain on sales of real estate investments		15,449	(15,449)	(100.0)%

Edgar Filing: Terreno Realty Corp - Form 10-Q

Total other income and (expenses)	(3,065)	10,952	(14,017)	n/a
Net income	\$ 10,122	\$ 20,933	\$ (10,811)	(51.6)%

<sup>1</sup> Includes 2017 and 2018 acquisitions and dispositions, one building held for sale to a third party with a gross book value of approximately \$3.2 million and accumulated depreciation and amortization of approximately \$0.7 million, eight improved land parcels and four redevelopment properties as of September 30, 2018.

<sup>2</sup> Includes straight-line rents and amortization of lease intangibles. See Non-GAAP Financial Measures in this Quarterly Report on Form 10-Q for a definition and reconciliation of net operating income and same store net operating income from net income and a discussion of why we believe net operating income and same store net operating income are useful supplemental measures of our operating performance.

*Revenues.* Total revenues increased approximately \$4.3 million for the three months ended September 30, 2018 compared to the same period from the prior year due primarily to property acquisitions during 2017 and 2018, increased revenue on new and renewed leases and lease termination income of approximately \$0.2 million. For the three months ended September 30, 2018 and 2017, approximately \$0.6 million and \$0.7 million, respectively, was recorded in straight-line rental revenues related to contractual rent abatements given to certain tenants.

*Property operating expenses.* Total property operating expenses increased approximately \$0.5 million during the three months ended September 30, 2018 compared to the same period from the prior year. The increase in total property operating expenses was primarily due to an increase of approximately \$0.5 million attributable to property acquisitions during 2017 and 2018.

*Depreciation and amortization.* Depreciation and amortization increased approximately \$0.5 million during the three months ended September 30, 2018 compared to the same period from the prior year due to property acquisitions during 2017 and 2018.

**Table of Contents**

*General and administrative expenses.* General and administrative expenses increased approximately \$6,000 for the three months ended September 30, 2018 compared to the same period from the prior year due primarily to an increase in overhead expenses of approximately \$0.6 million, offset by a decrease of approximately \$0.6 million in Performance Share award expense, which varies quarter to quarter based on our relative share price performance. Performance Share award expense for the three months ended September 30, 2018 was approximately \$1.3 million as compared to approximately \$1.9 million for the prior year period. See Note 10 Stockholders Equity in our condensed notes to consolidated financial statements for more information regarding our Performance Share awards.

*Interest and other income.* Interest and other income increased approximately \$1.3 million for the three months ended September 30, 2018 compared to the same period from the prior year primarily due to approximately \$1.1 million in interest earned on our Senior Secured Loan, which we made in May 2018.

*Interest expense, including amortization.* Interest expense decreased approximately \$0.1 million for the three months ended September 30, 2018 compared to the same period from the prior year due primarily to an increase of \$0.8 million in capitalized interest compared to the same period from the prior year, offset by an increase in our average outstanding borrowings on our credit facility and senior unsecured debt and higher interest rates.

*Gain on sales of real estate investments.* Gain on sales of real estate investments decreased approximately \$15.5 million for the three months ended September 30, 2018 compared to the same period from the prior year due to property sales. We did not sell any properties during the three months ended September 30, 2018, as compared to a recognized gain of approximately \$15.5 million from the sale of two properties in the same period from the prior year.

**Comparison of the Nine Months Ended September 30, 2018 to the Nine Months Ended September 30, 2017:**

	<b>For the Nine Months Ended September 30,</b>			
	<b>2018</b>	<b>2017</b>	<b>\$ Change</b>	<b>% Change</b>
	<b>(Dollars in thousands)</b>			
<b>Rental revenues</b>				
Same store	\$ 71,934	\$ 68,589	\$ 3,345	4.9%
Non-same store operating properties <sup>1</sup>	15,408	8,040	7,368	91.6%
<b>Total rental revenues</b>	<b>87,342</b>	<b>76,629</b>	<b>10,713</b>	<b>14.0%</b>
<b>Tenant expense reimbursements</b>				
Same store	21,007	19,485	1,522	7.8%
Non-same store operating properties <sup>1</sup>	3,895	1,745	2,150	123.2%
<b>Total tenant expense reimbursements</b>	<b>24,902</b>	<b>21,230</b>	<b>3,672</b>	<b>17.3%</b>
<b>Total revenues</b>	<b>112,244</b>	<b>97,859</b>	<b>14,385</b>	<b>14.7%</b>
<b>Property operating expenses</b>				
Same store	24,086	23,490	596	2.5%
Non-same store operating properties <sup>1</sup>	5,606	2,532	3,074	121.4%
<b>Total property operating expenses</b>	<b>29,692</b>	<b>26,022</b>	<b>3,670</b>	<b>14.1%</b>

Edgar Filing: Terreno Realty Corp - Form 10-Q

Net operating income <sup>2</sup>				
Same store	68,855	64,584	4,271	6.6%
Non-same store operating properties <sup>1</sup>	13,697	7,253	6,444	88.8%
<b>Total net operating income</b>	<b>\$ 82,552</b>	<b>\$ 71,837</b>	<b>\$ 10,715</b>	<b>14.9%</b>
Other costs and expenses				
Depreciation and amortization	30,566	27,855	2,711	9.7%
General and administrative	15,132	15,250	(118)	(0.8)%
Acquisition costs	129	11	118	1072.7%
<b>Total other costs and expenses</b>	<b>45,827</b>	<b>43,116</b>	<b>2,711</b>	<b>6.3%</b>
Other income (expense)				
Interest and other income	2,323	75	2,248	2997.3%
Interest expense, including amortization	(13,717)	(12,086)	(1,631)	13.5%
Gain on sales of real estate investments	14,986	25,549	(10,563)	(41.3)%
<b>Total other income and (expenses)</b>	<b>3,592</b>	<b>13,538</b>	<b>(9,946)</b>	<b>(73.5)%</b>
<b>Net income</b>	<b>\$ 40,317</b>	<b>\$ 42,259</b>	<b>\$ (1,942)</b>	<b>(4.6)%</b>

- <sup>1</sup> Includes 2017 and 2018 acquisitions and dispositions, one building held for sale to a third party with a gross book value of approximately \$3.2 million and accumulated depreciation and amortization of approximately \$0.7 million, eight improved land parcels and four redevelopment properties as of September 30, 2018.

**Table of Contents**

<sup>2</sup> Includes straight-line rents and amortization of lease intangibles. See *Non-GAAP Financial Measures* in this Quarterly Report on Form 10-Q for a definition and reconciliation of net operating income and same store net operating income from net income and a discussion of why we believe net operating income and same store net operating income are useful supplemental measures of our operating performance.

*Revenues.* Total revenues increased approximately \$14.4 million for the nine months ended September 30, 2018 compared to the same period from the prior year due primarily to property acquisitions during 2017 and 2018, increased revenue on new and renewed leases and lease termination income of approximately \$0.7 million. For the nine months ended September 30, 2018 and 2017, approximately \$2.5 million and \$2.2 million, respectively, was recorded in straight-line rental revenues related to contractual rent abatements given to certain tenants.

*Property operating expenses.* Total property operating expenses increased approximately \$3.7 million during the nine months ended September 30, 2018 compared to the same period from the prior year. The increase in total property operating expenses was primarily due to an increase of approximately \$3.1 million attributable to property acquisitions during 2017 and 2018.

*Depreciation and amortization.* Depreciation and amortization increased approximately \$2.7 million during the nine months ended September 30, 2018 compared to the same period from the prior year due to property acquisitions during 2017 and 2018.

*General and administrative expenses.* General and administrative expenses decreased approximately \$0.1 million for the nine months ended September 30, 2018 compared to the same period from the prior year due primarily to a decrease of approximately \$1.2 million in Performance Share award expense, which varies quarter to quarter based on our relative share price performance, partially offset by an increase in overhead expenses of \$1.1 million. Performance Share award expense for the nine months ended September 30, 2018 was approximately \$4.3 million as compared to approximately \$5.6 million for the prior year period. See *Note 10 Stockholders Equity* in our condensed notes to consolidated financial statements for more information regarding our Performance Share awards.

*Interest and other income.* Interest and other income increased approximately \$2.2 million for the nine months ended September 30, 2018 compared to the same period from the prior year primarily due to approximately \$1.8 million in interest earned on our Senior Secured Loan, which we made in May 2018.

*Interest expense, including amortization.* Interest expense increased approximately \$1.6 million for the nine months ended September 30, 2018 compared to the same period from the prior year due primarily to an increase in our average outstanding borrowings on our credit facility and senior unsecured debt, offset by capitalized interest.

*Gain on sales of real estate investments.* Gain on sales of real estate investments decreased approximately \$10.6 million for the nine months ended September 30, 2018 compared to the same period from the prior year due to property sales. For the nine months ended September 30, 2018, we recognized a cumulative gain of approximately \$15.0 million from the sale of two properties, as compared to a gain of approximately \$25.5 million from the sale of three properties in the same period from the prior year.



**Table of Contents**

**Liquidity and Capital Resources**

The primary objective of our financing strategy is to maintain financial flexibility with a conservative capital structure using retained cash flows, proceeds from dispositions of properties, long-term debt and the issuance of common and perpetual preferred stock to finance our growth. Over the long-term, we intend to:

limit the sum of the outstanding principal amount of our consolidated indebtedness and the liquidation preference of any outstanding perpetual preferred stock to less than 35% of our total enterprise value;

maintain a fixed charge coverage ratio in excess of 2.0x;

maintain a debt-to-adjusted EBITDA ratio below 6.0x;

limit the principal amount of our outstanding floating rate debt to less than 20% of our total consolidated indebtedness; and

have staggered debt maturities that are aligned to our expected average lease term (5-7 years), positioning us to re-price parts of our capital structure as our rental rates change with market conditions.

We intend to preserve a flexible capital structure with a long-term goal to maintain our investment grade rating and be in a position to issue additional unsecured debt and additional perpetual preferred stock. Fitch Ratings assigned us an issuer rating of BBB- with a stable outlook. A security rating is not a recommendation to buy, sell or hold securities and may be subject to revision or withdrawal at any time by the assigning rating agency. There can be no assurance that we will be able to maintain our current credit rating. Our credit rating can affect the amount and type of capital we can access, as well as the terms of any financings we may obtain. In the event our current credit rating is downgraded, it may become difficult or expensive to obtain additional financing or refinance existing obligations and commitments. We intend to primarily utilize senior unsecured notes, term loans, credit facilities, dispositions of properties, common stock and perpetual preferred stock. We may also assume debt in connection with property acquisitions which may have a higher loan-to-value.

We expect to meet our short-term liquidity requirements generally through net cash provided by operations, existing cash balances and, if necessary, short-term borrowings under our credit facility. We believe that our net cash provided by operations will be adequate to fund operating requirements, pay interest on any borrowings and fund distributions in accordance with the REIT requirements of the federal income tax laws. In the near-term, we intend to fund future investments in properties with term loans, senior unsecured notes, mortgages, borrowings under our credit facility, perpetual preferred and common stock issuances and, from time to time, property dispositions. We expect to meet our long-term liquidity requirements, including with respect to other investments in industrial properties, property acquisitions and scheduled debt maturities, through borrowings under our credit facility, periodic issuances of common stock, perpetual preferred stock, and long-term secured and unsecured debt, and with proceeds from the disposition of properties. The success of our acquisition strategy may depend, in part, on our ability to obtain and borrow under our credit facility and to access additional capital through issuances of equity and debt securities.

The following sets forth certain information regarding our current at-the-market common stock offering program as of September 30, 2018:

<b>ATM Stock Offering Program</b>	<b>Date Implemented</b>	<b>Maximum Aggregate Offering Price (in thousands)</b>	<b>Aggregate Common Stock Available as of September 30, 2018 (in thousands)</b>
\$250 Million ATM Program	May 31, 2018	\$ 250,000	\$ 202,949

The table below sets forth the activity under our at-the-market common stock offering programs during the three and nine months ended September 30, 2018 and 2017, respectively (in thousands, except share and price per share data):

<b>For the Three Months Ended</b>	<b>Shares Sold</b>	<b>Weighted Average Price Per Share</b>	<b>Net Proceeds (in thousands)</b>	<b>Sales Commissions (in thousands)</b>
September 30, 2018	729,667	\$ 38.22	\$ 27,483	\$ 404
September 30, 2017	2,206,685	\$ 35.84	\$ 77,935	\$ 1,147

**Table of Contents**

<b>For the Nine Months Ended</b>	<b>Shares Sold</b>	<b>Weighted Average</b>	<b>Net Proceeds (in thousands)</b>	<b>Sales Commissions</b>
		<b>Price Per Share</b>		<b>(in thousands)</b>
September 30, 2018	3,615,068	\$ 37.59	\$ 133,907	\$ 1,970
September 30, 2017	7,042,771	\$ 31.87	\$ 221,207	\$ 3,262

On May 7, 2018, we made a Senior Secured Loan of \$55.0 million with a two-year term that bears interest at a fixed annual interest rate of 8.0% and matures in May 2020. The Senior Secured Loan is secured by a portfolio of nine improved land parcels primarily located in Newark and Kearny, New Jersey. One of the properties securing the Senior Secured Loan may be put to us as partial repayment of the Senior Secured Loan. This property, and two of the other properties, may be called by us as partial or full repayment of the Senior Secured Loan at previously agreed upon values. In addition, per the terms of the Senior Secured Loan, the borrower may repay the loan at any time with either cash or deeds in lieu, with the deeds subject to our approval. As of September 30, 2018, the borrower has offered repayment with deeds in lieu on two of the three option properties for an aggregate purchase price of approximately \$39.1 million. As of November 1, 2018, we have entered into two non-binding letters of intent to acquire two of the three option properties for approximately \$39.1 million. In the normal course of our business, we enter into non-binding letters of intent to purchase properties from third parties that may obligate us to make payments or perform other obligations upon the occurrence of certain events, including the execution of a purchase and sale agreement and satisfactory completion of various due diligence matters. There can be no assurance that we will enter into purchase and sale agreements with respect to these properties or otherwise complete any such prospective purchases on the terms described or at all. As of September 30, 2018 and December 31, 2017, there was approximately \$54.3 million and \$0, respectively, net of deferred loan fees of approximately \$0.7 million and \$0, respectively, outstanding on the Senior Secured Loan and approximately \$0.4 million and \$0, respectively, of interest receivable outstanding on the Senior Secured Loan.

As of September 30, 2018, we had \$50.0 million of senior unsecured notes that mature in September 2022, \$100.0 million of senior unsecured notes that mature in July 2024, \$50.0 million of senior unsecured notes that mature in July 2026, \$50.0 million of senior unsecured notes that mature in October 2027 (collectively, the Senior Unsecured Notes), and a credit facility (the Facility), which consists of a \$200.0 million unsecured revolving credit facility that matures in August 2020, a \$50.0 million term loan that matures in August 2021 and a \$100.0 million term loan that matures in January 2022. As of September 30, 2018 and December 31, 2017, there was \$21.9 million and \$0, respectively, of borrowings outstanding on our revolving credit facility and \$150.0 million and \$150.0 million, respectively, of borrowings outstanding on our term loans. We have three interest rate caps to hedge the variable cash flows associated with our existing \$150.0 million of variable-rate term loans. See Note 8-Derivative Financial Instruments in our condensed notes to consolidated financial statements for more information regarding our interest rate caps.

The description of the Facility in this paragraph is as of September 30, 2018. The aggregate amount of the Facility may be increased to a total of up to \$600.0 million, subject to the approval of the administrative agent and the identification of lenders willing to make available additional amounts. Outstanding borrowings under the Facility are limited to the lesser of (i) the sum of the \$150.0 million term loans and the \$200.0 million revolving credit facility, or (ii) 60.0% of the value of the unencumbered properties. Interest on the Facility, including the term loans, is generally to be paid based upon, at our option, either (i) LIBOR plus the applicable LIBOR margin or (ii) the applicable base rate which is the greatest of the administrative agent's prime rate, 0.50% above the federal funds effective rate, or thirty-day LIBOR plus the applicable LIBOR margin for LIBOR rate loans under the Facility plus 1.25%. The applicable LIBOR margin will range from 1.35% to 1.90% (1.35% as of September 30, 2018) for the revolving credit facility and 1.30% to 1.85% (1.30% as of September 30, 2018) for the \$50.0 million term loan that matures in August 2021 and the \$100.0 million term loan that matures in January 2022, depending on the ratio of our outstanding

consolidated indebtedness to the value of our consolidated gross asset value. The Facility requires quarterly payments of an annual unused facility fee in an amount equal to 0.20% or 0.25% depending on the unused portion of the revolving credit facility.

On October 19, 2018, we entered into a Fifth Amended and Restated Senior Credit Agreement (the Amended Facility ). The Amended Facility consists of a \$250.0 million unsecured revolving credit facility (increased from \$200.0 million) that matures in October 2022 (previously August 2020), a \$50.0 million term loan that matures in August 2021 and a \$100.0 million term loan that matures in January 2022. The amount and maturity dates of the outstanding term loans remain unchanged under the Amended Facility. Outstanding borrowings under the Amended Facility are limited to the lesser of (i) the sum of the \$250.0 million revolving credit facility, the \$50.0 million term loan maturing in August 2021 and the \$100.0 million term loan maturing in January 2022 or (ii) 60.0% of the value of the unencumbered properties. The applicable LIBOR margin with respect to the revolving credit facility under the Amended Facility has been reduced to a range of 1.05% to 1.50% and the applicable LIBOR margin with respect to the outstanding term loans under the Amended Facility has been reduced to a range of 1.20% to 1.70%, in each case depending on the ratio of our outstanding consolidated indebtedness to the value of our consolidated gross asset value. The Amended Facility requires quarterly payments of an annual facility fee in an amount ranging from 0.15% to 0.30% depending on the ratio of our outstanding consolidated indebtedness to the value of our consolidated gross asset value. There is no unused facility fee under the Amended Facility.

**Table of Contents**

The Amended Facility and the Senior Unsecured Notes are guaranteed by us and by substantially all of the current and to-be-formed subsidiaries of the borrower that own an unencumbered property. The Amended Facility and the Senior Unsecured Notes are unsecured by our properties or by interests in the subsidiaries that hold such properties. The Amended Facility and the Senior Unsecured Notes include a series of financial and other covenants with which we must comply. We were in compliance with the covenants under the Facility and the Senior Unsecured Notes as of September 30, 2018 and December 31, 2017.

As of September 30, 2018 and December 31, 2017, we had outstanding mortgage loans payable, net of deferred financing costs, of approximately \$63.5 million and \$64.8 million, respectively, and held cash and cash equivalents totaling approximately \$3.6 million and \$35.7 million, respectively.

The following tables summarize our debt maturities and principal payments and market capitalization, capitalization ratios, Adjusted EBITDA, interest coverage, fixed charge coverage and debt ratios as of and for the nine months ended September 30, 2018 and 2017 (dollars in thousands - except per share data):

	<b>Credit Facility</b>	<b>Term Loans</b>	<b>Senior Unsecured Notes</b>	<b>Mortgage Loans Payable</b>	<b>Total Debt</b>
2018 (3 months)	\$	\$	\$	\$ 485	\$ 485
2019				18,805	18,805
2020	21,850			33,077	54,927
2021		50,000		11,271	61,271
2022		100,000	50,000		150,000
Thereafter			200,000		200,000
<b>Total Debt</b>	21,850	150,000	250,000	63,638	485,488
Deferred financing costs, net		(886)	(1,812)	(136)	(2,834)
<b>Total Debt, net</b>	\$ 21,850	\$ 149,114	\$ 248,188	\$ 63,502	\$ 482,654
Weighted Average Interest Rate	3.5%	3.4%	4.1%	4.0%	3.8%

**Table of Contents**

	As of September 30, 2018	As of September 30, 2017
<b>Total Debt, net</b>	\$ 482,654	\$ 461,971
<b>Equity</b>		
Common Stock		
Shares Outstanding <sup>1</sup>	59,136,072	54,569,238
Market Price <sup>2</sup>	\$ 37.70	\$ 36.18
<b>Total Equity</b>	2,229,430	1,974,315
<b>Total Market Capitalization</b>	\$ 2,712,084	\$ 2,436,286
Total Debt-to-Total Investments in Properties <sup>3</sup>	26.8%	30.3%
Total Debt-to-Total Investments in Properties and Senior Secured Loan <sup>4</sup>	26.2%	30.3%
Total Debt-to-Total Market Capitalization <sup>5</sup>	17.8%	19.0%
Floating Rate Debt as a % of Total Debt <sup>6</sup>	35.4%	32.2%
Unhedged Floating Rate Debt as a % of Total Debt <sup>7</sup>	4.5%	0.0%
Mortgage Loans Payable as a % of Total Debt <sup>8</sup>	13.2%	14.1%
Mortgage Loans Payable as a % of Total Investments in Properties <sup>9</sup>	3.5%	4.3%
Adjusted EBITDA <sup>10</sup>	\$ 75,765	\$ 63,923
Interest Coverage <sup>11</sup>	5.5x	5.3x
Fixed Charge Coverage <sup>12</sup>	4.9x	4.6x
Total Debt-to-Adjusted EBITDA <sup>13</sup>	4.6x	5.2x
Weighted Average Maturity of Total Debt (years)	4.6	5.7

<sup>1</sup> Includes 383,930 and 374,842 shares of unvested restricted stock outstanding as of September 30, 2018 and 2017, respectively.

<sup>2</sup> Closing price of our shares of common stock on the New York Stock Exchange on September 28, 2018 and September 29, 2017, respectively, in dollars per share.

<sup>3</sup> Total debt-to-total investments in properties is calculated as total debt, including premiums and net of deferred financing costs, divided by total investments in properties, including properties held for sale with gross book values of approximately \$3.2 million and \$6.9 million, as of September 30, 2018 and 2017, respectively.

<sup>4</sup> Total debt-to-total investments in properties and Senior Secured Loan is calculated as total debt, including premiums and net of deferred financing costs, divided by total investments in properties, including properties

held for sale with gross book values of approximately \$3.2 million and \$6.9 million, as of September 30, 2018 and 2017, respectively, and total Senior Secured Loan, net of deferred loan fees of approximately \$0.7 million and \$0 million, as of September 30, 2018 and 2017, respectively.

- 5 Total debt-to-total market capitalization is calculated as total debt, including premiums and net of deferred financing costs, divided by total market capitalization as of September 30, 2018 and 2017, respectively.
- 6 Floating rate debt as a percentage of total debt is calculated as floating rate debt, including premiums and net of deferred financing costs, divided by total debt, including premiums and net of deferred financing costs. Floating rate debt includes our existing \$150.0 million of variable-rate term loan borrowings with interest rate caps of 4.0% plus 1.30% to 1.85%, depending on leverage as of September 30, 2018 and 2017. See Note 8-Derivative Financial Instruments in our condensed notes to consolidated financial statements for more information regarding our interest rate caps.
- 7 Unhedged floating rate debt as a percentage of total debt is calculated as unhedged floating rate debt, including premiums and net of deferred financing costs, divided by total debt, including premiums and net of deferred financing costs. Hedged debt includes our existing \$150.0 million of variable-rate term loan borrowings with interest rate caps of 4.0% plus 1.30% to 1.85%, depending on leverage as of September 30, 2018 and 2017. See Note 8-Derivative Financial Instruments in our condensed notes to consolidated financial statements for more information regarding our interest rate caps.

**Table of Contents**

- 8 Mortgage loans payable as a percentage of total debt is calculated as mortgage loans payable, including premiums and net of deferred financing costs, divided by total debt, including premiums and net of deferred financing costs.
- 9 Mortgage loans payable as a percentage of total investments in properties is calculated as mortgage loans payable, including premiums and net of deferred financing costs, divided by total investments in properties, including properties held for sale with gross book values of approximately \$3.2 million and \$6.9 million, as of September 30, 2018 and 2017, respectively.
- 10 Earnings before interest, taxes, gains (losses) from sales of property, depreciation and amortization, acquisition costs and stock-based compensation ( Adjusted EBITDA ) for the nine months ended September 30, 2018 and 2017, respectively. See Non-GAAP Financial Measures in this Quarterly Report on Form 10-Q for a definition and reconciliation of Adjusted EBITDA from net income and a discussion of why we believe Adjusted EBITDA is a useful supplemental measure of our operating performance.
- 11 Interest coverage is calculated as Adjusted EBITDA divided by interest expense, including amortization. See Non-GAAP Financial Measures in this Quarterly Report on Form 10-Q for a definition and reconciliation of Adjusted EBITDA from net income and a discussion of why we believe Adjusted EBITDA is a useful supplemental measure of our operating performance.
- 12 Fixed charge coverage is calculated as Adjusted EBITDA divided by interest expense, including amortization plus preferred stock dividends. We redeemed all of our outstanding shares of Series A Preferred Stock in July 2017. See Non-GAAP Financial Measures in this Quarterly Report on Form 10-Q for a definition and reconciliation of Adjusted EBITDA from net income and a discussion of why we believe Adjusted EBITDA is a useful supplemental measure of our operating performance.
- 13 Total debt-to-Adjusted EBITDA is calculated as total debt, including premiums and net of deferred financing costs, divided by annualized Adjusted EBITDA. See Non-GAAP Financial Measures in this Quarterly Report on Form 10-Q for a definition and reconciliation of Adjusted EBITDA from net income and a discussion of why we believe Adjusted EBITDA is a useful supplemental measure of our operating performance.

The following table sets forth the cash dividends paid or payable per share during the nine months ended September 30, 2018:

**For the Three Months**

Ended	Dividend per					
	Security	Share	Declaration Date	Record Date	Date Paid	
March 31, 2018	Common stock	\$ 0.22	February 6, 2018	March 28, 2018	April 12, 2018	
June 30, 2018	Common stock	\$ 0.22	May 1, 2018	July 6, 2018	July 20, 2018	
September 30, 2018	Common stock	\$ 0.24	August 1, 2018	October 5, 2018	October 19, 2018	

**Sources and Uses of Cash**

Our principal sources of cash are cash from operations, borrowings under loans payable, draws on our Amended Facility, common and preferred stock issuances, proceeds from property dispositions and issuances of unsecured notes. Our principal uses of cash are asset acquisitions, debt service, capital expenditures, operating costs, corporate overhead costs and common stock dividends.

*Cash From Operating Activities.* Net cash provided by operating activities totaled approximately \$57.0 million for the nine months ended September 30, 2018 compared to approximately \$53.7 million for the nine months ended September 30, 2017. This increase in cash provided by operating activities is primarily attributable to additional cash flows generated from the properties acquired during 2017 and 2018 and from interest received on our Senior Secured Loan, which we made in May 2018.



*Cash From Investing Activities.* Net cash used in investing activities was approximately \$204.9 million and \$144.9 million, respectively, for the nine months ended September 30, 2018 and 2017, which consists primarily of cash paid for property acquisitions of approximately \$169.1 million and \$190.1 million, respectively, net cash paid for our Senior Secured Loan of approximately \$54.1 million and \$0, respectively, and additions to capital improvements of approximately \$24.7 million and \$18.9 million, respectively, offset by net proceeds from sales of real estate investments of approximately \$43.0 million and \$64.2 million, respectively.

**Table of Contents**

*Cash From Financing Activities.* Net cash provided by financing activities was approximately \$113.2 million for the nine months ended September 30, 2018, which consists primarily of approximately \$133.9 million in net common stock issuance proceeds and approximately \$21.9 million in net borrowings on our revolving credit facility, offset by approximately \$37.3 million in equity dividend payments. Net cash provided by financing activities was approximately \$186.1 million for the nine months ended September 30, 2017, which consists primarily of approximately \$221.2 million in net common stock issuance proceeds and \$100.0 million in borrowings on our senior unsecured notes offset by approximately \$31.9 million in equity dividend payments, the repurchase of approximately \$46.0 million in preferred stock, and net payments on our revolving credit facility of approximately \$51.5 million.

**Critical Accounting Policies**

A summary of our critical accounting policies is set forth in our Annual Report on Form 10-K for the year ended December 31, 2017 and in the condensed notes to our consolidated financial statements in this Quarterly Report on Form 10-Q.

**Off-Balance Sheet Arrangements**

We do not have any off-balance sheet arrangements that have or are reasonably likely to have a current or future effect on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources that are material to investors.

**Contractual Obligations**

As of November 1, 2018, we have two outstanding contracts with third-party sellers to acquire two industrial properties. There is no assurance that we will acquire the properties under contract because the proposed acquisitions are subject to the completion of satisfactory due diligence and various closing conditions.

The following table summarizes certain information with respect to the properties we have under contract:

<b>Market</b>	<b>Number of Buildings</b>	<b>Square Feet</b>	<b>Purchase Price (in Assumed Debt (in thousands))</b>	
Los Angeles <sup>1</sup>	1	60,040	\$ 17,508	\$
Northern New Jersey/New York City				
San Francisco Bay Area				
Seattle				
Miami				
Washington, D.C.				
<b>Total</b>	<b>1</b>	<b>60,040</b>	<b>\$ 17,508</b>	<b>\$</b>

<sup>1</sup> Includes one improved land parcel containing approximately 2.3 acres.

As of November 1, 2018, we have executed four non-binding letters of intent with third-party sellers to acquire four industrial properties. The total anticipated purchase price for these industrial properties is approximately \$51.0 million. In the normal course of business, we enter into non-binding letters of intent to purchase properties from

third parties that may obligate us to make payments or perform other obligations upon the occurrence of certain events, including the execution of a purchase and sale agreement and satisfactory completion of various due diligence matters. There can be no assurance that we will enter into purchase and sale agreements with respect to these properties or otherwise complete any such prospective purchases on the terms described or at all.

As of November 1, 2018, we have two outstanding contracts with third-party purchasers to sell two properties for an aggregate sales price of approximately \$38.8 million (aggregate net book value of approximately \$23.0 million). There is no assurance we will sell the properties under contract because the proposed dispositions are subject to the purchaser's completion of satisfactory due diligence and various closing conditions.

**Table of Contents**

The following table summarizes our contractual obligations due by period as of September 30, 2018 (dollars in thousands):

Contractual Obligations	Less than 1			More than 5		Total
	Year	1-3 Years	3-5 Years	Years		
Debt	\$ 18,906	\$ 116,582	\$ 150,000	\$ 200,000	\$ 485,488	
Debt interest payments	12,343	21,966	18,255	20,198	72,762	
Operating lease commitments	263	544	210		1,017	
Purchase obligations	17,508				17,508	
<b>Total</b>	<b>\$ 49,020</b>	<b>\$ 139,092</b>	<b>\$ 168,465</b>	<b>\$ 220,198</b>	<b>\$ 576,775</b>	

**Non-GAAP Financial Measures**

We use the following non-GAAP financial measures that we believe are useful to investors as key supplemental measures of our operating performance: funds from operations, or FFO, Adjusted EBITDA, net operating income, or NOI, same store NOI and cash-basis same store NOI. FFO, Adjusted EBITDA, NOI, same store NOI and cash-basis same store NOI should not be considered in isolation or as a substitute for measures of performance in accordance with GAAP. Further, our computation of FFO, Adjusted EBITDA, NOI, same store NOI and cash-basis same store NOI may not be comparable to FFO, Adjusted EBITDA, NOI, same store NOI and cash-basis same store NOI reported by other companies.

We compute FFO in accordance with standards established by the National Association of Real Estate Investment Trusts ( Nareit ), which defines FFO as net income (loss) (determined in accordance with GAAP), excluding gains (losses) from sales of property and impairment write-downs of depreciable real estate, plus depreciation and amortization on real estate assets and after adjustments for unconsolidated partnerships and joint ventures (which are calculated to reflect FFO on the same basis). We believe that presenting FFO provides useful information to investors regarding our operating performance because it is a measure of our operations without regard to specified non-cash items, such as real estate depreciation and amortization and gain or loss on sale of assets.

We believe that FFO is a meaningful supplemental measure of our operating performance because historical cost accounting for real estate assets in accordance with GAAP implicitly assumes that the value of real estate assets diminishes predictably over time. Since real estate values have historically risen or fallen with market conditions, many industry investors and analysts have considered the presentation of operating results for real estate companies that use historical cost accounting alone to be insufficient. As a result, we believe that the use of FFO, together with the required GAAP presentations, provide a more complete understanding of our operating performance.

The following table reflects the calculation of FFO reconciled from net income, net of redemption of preferred stock and preferred stock dividends, for the three and nine months ended September 30, 2018 and 2017 (dollars in thousands except per share data):

<i>For the Three Months Ended</i>				<i>For the Nine Months Ended</i>			
<i>September 30,</i>				<i>September 30,</i>			
<i>2018</i>	<i>2017</i>	<i>\$ Change</i>	<i>% Change</i>	<i>2018</i>	<i>2017</i>	<i>\$ Change</i>	<i>% Change</i>

Edgar Filing: Terreno Realty Corp - Form 10-Q

Net income, net of redemption of preferred stock and preferred stock dividends	\$	10,122	\$	18,988	\$	(8,866)	(46.7)%	\$	40,317	\$	38,531	\$	1,786	4.6%
Gain on sales of real estate investments				(15,449)		15,449	n/a		(14,986)		(25,549)		10,563	(41.3)%
Depreciation and amortization														
Depreciation and amortization		10,057		9,595		462	4.8%		30,566		27,855		2,711	9.7%
Non-real estate depreciation		(28)		(30)		2	(6.7)%		(86)		(78)		(8)	10.3%
Allocation to participating securities <sup>1</sup>		(130)		(90)		(40)	44.4%		(355)		(297)		(58)	19.5%
Funds from operations attributable to common stockholders <sup>2,3</sup>	\$	20,021	\$	13,014	\$	7,007	53.8%	\$	55,456	\$	40,462	\$	14,994	37.1%
Basic and diluted FFO per common share	\$	0.34	\$	0.25	\$	0.09	36.0%	\$	0.98	\$	0.80	\$	0.18	22.5%
Weighted average basic and diluted common shares		58,369,252		52,804,611					56,743,805		50,277,432			

<sup>1</sup> To be consistent with our policies of determining whether instruments granted in share-based payment transactions are participating securities and accounting for earnings per share, the FFO per common share is adjusted for FFO distributed through declared dividends (if any) and allocated to all participating securities (weighted average common shares outstanding and unvested restricted shares outstanding) under the two-class method. Under this method, allocations were made to 374,862 and 374,842 of weighted average unvested restricted shares outstanding for the three months ended September 30, 2018 and 2017, respectively, and to

Edgar Filing: Terreno Realty Corp - Form 10-Q

363,850 and 381,321 of weighted average unvested restricted shares outstanding for the nine months ended September 30, 2018 and 2017, respectively.

**Table of Contents**

- <sup>2</sup> Includes expensed acquisition costs of approximately \$0.1 million and \$0 for the three months ended September 30, 2018 and 2017, respectively, and approximately \$0.1 million and \$11,000 for the nine months ended September 30, 2018 and 2017, respectively.
- <sup>3</sup> Includes Performance Share award expense of approximately \$1.3 million and \$1.9 million for the three months ended September 30, 2018 and 2017, respectively, and approximately \$4.3 million and \$5.6 million for the nine months ended September 30, 2018 and 2017, respectively, which varies quarter to quarter based our total shareholder return outperforming the MSCI U.S. REIT Index (RMS) and the FTSE Nareit Equity Industrial Index over the prior three year period. See Note 10 Stockholders Equity in our condensed notes to consolidated financial statements for more information regarding our Performance Share awards.

FFO increased by approximately \$7.0 million and \$15.0 million for the three and nine months ended September 30, 2018, respectively, compared to the same periods from the prior year due primarily to property acquisitions during 2017 and 2018 and same store NOI growth of approximately \$1.7 million and \$4.3 million for the three and nine months ended September 30, 2018, respectively, compared to the same periods from the prior year. The FFO increase was offset by increased weighted average common shares outstanding for the three and nine months ended September 30, 2018, respectively, compared to the same periods from the prior year.

We compute Adjusted EBITDA as earnings before interest, taxes, depreciation and amortization, gain on sales of real estate investments, acquisition costs and stock-based compensation. We believe that presenting Adjusted EBITDA provides useful information to investors regarding our operating performance because it is a measure of our operations on an unleveraged basis before the effects of tax, gain (loss) on sales of real estate investments, non-cash depreciation and amortization expense, acquisition costs and stock-based compensation. By excluding interest expense, Adjusted EBITDA allows investors to measure our operating performance independent of our capital structure and indebtedness and, therefore, allows for more meaningful comparison of our operating performance between quarters and other interim periods as well as annual periods and for the comparison of our operating performance to that of other companies, both in the real estate industry and in other industries. As we are currently in a growth phase, acquisition costs are excluded from Adjusted EBITDA to allow for the comparison of our operating performance to that of stabilized companies.

The following table reflects the calculation of Adjusted EBITDA reconciled from net income for the three and nine months ended September 30, 2018 and 2017 (dollars in thousands):

	<i>For the Three Months Ended September 30,</i>				<i>For the Nine Months Ended September 30,</i>			
	<i>2018</i>	<i>2017</i>	<i>\$ Change</i>	<i>% Change</i>	<i>2018</i>	<i>2017</i>	<i>\$ Change</i>	<i>% Change</i>
Net income	\$ 10,122	\$ 20,933	\$ (10,811)	(51.6)%	\$ 40,317	\$ 42,259	\$ (1,942)	(4.6)%
Gain on sales of real estate investments		(15,449)	15,449	n/a	(14,986)	(25,549)	10,563	(41.3)%
Depreciation and amortization	10,057	9,595	462	4.8%	30,566	27,855	2,711	9.7%
Interest expense, including amortization	4,406	4,514	(108)	(2.4)%	13,717	12,086	1,631	13.5%
Stock-based compensation	1,793	2,411	(618)	(25.6)%	6,022	7,261	(1,239)	(17.1)%
Acquisition costs	122		122	n/a	129	11	118	1072.7%

Edgar Filing: Terreno Realty Corp - Form 10-Q

Adjusted EBITDA	\$ 26,500	\$ 22,004	\$ 4,496	20.4%	\$ 75,765	\$ 63,923	\$ 11,842	18.5%
-----------------	-----------	-----------	----------	-------	-----------	-----------	-----------	-------

We compute NOI as rental revenues, including tenant expense reimbursements, less property operating expenses. We compute same store NOI as rental revenues, including tenant expense reimbursements, less property operating expenses on a same store basis. NOI excludes depreciation, amortization, general and administrative expenses, acquisition costs and interest expense. We compute cash-basis same store NOI as same store NOI excluding straight-line rents and amortization of lease intangibles. The same store pool includes all properties that were owned and in operation as of September 30, 2018 and since January 1, 2017 and excludes properties that were either disposed of prior to, held for sale to a third party or in redevelopment as of September 30, 2018. As of September 30, 2018, the same store pool consisted of 157 buildings aggregating approximately 10.7 million square feet representing approximately 82.7% of our total square feet owned and five improved land parcels consisting of 22.8 acres. We believe that presenting NOI, same store NOI and cash-basis same store NOI provides useful information to investors regarding the operating performance of our properties because NOI excludes certain items that are not considered to be controllable in connection with the management of the properties, such as depreciation, amortization, general and administrative expenses, acquisition costs and interest expense. By presenting same store NOI and cash-basis same store NOI, the operating results on a same store basis are directly comparable from period to period.



**Table of Contents**

The following table reflects the calculation of NOI, same store NOI and cash-basis same store NOI reconciled from net income for the three and nine months ended September 30, 2018 and 2017 (dollars in thousands):

	<i>For the Three Months Ended September 30,</i>				<i>For the Nine Months Ended September 30,</i>			
	<i>2018</i>	<i>2017</i>	<i>\$ Change</i>	<i>% Change</i>	<i>2018</i>	<i>2017</i>	<i>\$ Change</i>	<i>% Change</i>
1	\$ 10,122	\$ 20,933	\$ (10,811)	(51.6)%	\$ 40,317	\$ 42,259	\$ (1,942)	
Depreciation and amortization	10,057	9,595	462	4.8%	30,566	27,855	2,711	
General and administrative	5,047	5,041	6	0.1%	15,132	15,250	(118)	
Other costs	122		122	n/a	129	11	118	
Other income and expenses	3,065	(10,952)	14,017	n/a	(3,592)	(13,538)	9,946	
Operating income	28,413	24,617	3,796	15.4%	82,552	71,837	10,715	
Same store NOI <sup>2</sup>	(4,980)	(2,900)	(2,080)	71.7%	(13,697)	(7,253)	(6,444)	
Cash-basis NOI <sup>3</sup>	\$ 23,433	\$ 21,717	\$ 1,716	7.9%	\$ 68,855	\$ 64,584	\$ 4,271	
Adjustment for straight-line rents and amortization of lease intangibles <sup>4</sup>	(514)	(822)	308	(37.5)%	(2,448)	(3,296)	848	
Cash-basis same store NOI <sup>3</sup>	\$ 22,919	\$ 20,895	\$ 2,024	9.7%	\$ 66,407	\$ 61,288	\$ 5,119	

<sup>1</sup> Includes approximately \$0.2 million and \$0.1 million of lease termination income for the three months ended September 30, 2018 and 2017, respectively, and approximately \$0.7 million and \$0.1 million of lease termination income for the nine months ended September 30, 2018 and 2017, respectively.

<sup>2</sup> Includes 2017 and 2018 acquisitions and dispositions and one building held for sale to a third party with a gross book value of approximately \$3.2 million and accumulated depreciation and amortization of approximately \$0.7 million, eight improved land parcels and four redevelopment properties.

<sup>3</sup> Includes approximately \$0.2 million and \$0.1 million of lease termination income for the three months ended September 30, 2018 and 2017, respectively, and approximately \$0.7 million and \$0.1 million of lease termination income for the nine months ended September 30, 2018 and 2017, respectively.

<sup>4</sup> Includes straight-line rents and amortization of lease intangibles for the same store pool only.

Cash-basis same store NOI increased by approximately \$2.0 million for the three months ended September 30, 2018 compared to the same period from the prior year primarily due to increased rental revenue on new and renewed leases and approximately \$0.2 million in lease termination income, which was offset by approximately \$0.2 million in rent abatements provided to the tenant at our Belleville property. Total contractual rent abatements of approximately \$0.3 million for both the three months ended September 30, 2018 and 2017 were given to certain tenants in the same-store pool. In addition, approximately \$0.5 million of the increase in cash-basis same store NOI for the three months ended September 30, 2018 related to properties that were acquired vacant or with near term expirations.

Cash-basis same store NOI increased by approximately \$5.1 million for the nine months ended September 30, 2018 compared to the same period from the prior year primarily due to increased rental revenue and tenant reimbursement revenue on new and renewed leases and approximately \$0.7 million in lease termination income, offset by approximately \$0.6 million in rent abatements provided to the tenant at our Belleville property. The vacant space at our Hart property was re-leased in March 2018 with cash rent increasing by approximately 27.8%. In addition,

## Edgar Filing: Terreno Realty Corp - Form 10-Q

approximately \$0.2 million in bad debt expense was recovered during the nine months ended September 30, 2017 at our 221 Michele property. Contractual rent abatements of approximately \$1.9 million and \$1.6 million for the nine months ended September 30, 2018 and 2017, respectively, were given to certain tenants in the same-store pool. In addition, approximately \$1.5 million of the increase in cash-basis same store NOI for the nine months ended September 30, 2018 related to properties that were acquired vacant or with near term expirations.

## **Table of Contents**

### **Item 3. Quantitative and Qualitative Disclosures About Market Risk**

Market risk includes risks that arise from changes in interest rates, foreign currency exchange rates, commodity prices, equity prices and other market changes that affect market sensitive instruments. In pursuing our business strategies, the primary market risk which we are exposed to is interest rate risk. We are exposed to interest rate changes primarily as a result of debt used to maintain liquidity, fund capital expenditures and expand our investment portfolio and operations. We seek to limit the impact of interest rate changes on earnings and cash flows and to lower our overall borrowing costs. As described below, some of our outstanding debt bears interest at variable rates, and we expect that some of our future outstanding debt will have variable interest rates. We may use interest rate caps and/or swap agreements to manage our interest rate risks relating to our variable rate debt. We expect to replace variable rate debt on a regular basis with fixed rate, long-term debt to finance our assets and operations.

As of September 30, 2018, we had \$171.9 million of borrowings outstanding under our Facility. Of the \$171.9 million outstanding on the Facility, \$150.0 million is subject to interest rate caps. See Note 8-Derivative Financial Instruments in our condensed notes to consolidated financial statements for more information regarding our interest rate caps. Amounts borrowed under our Facility bear interest at a variable rate based on LIBOR plus an applicable LIBOR margin. The weighted average interest rate on borrowings outstanding under our Facility was 3.45% as of September 30, 2018. If the LIBOR rate fluctuates by 0.25%, interest expense would increase or decrease, depending on rate movement, future earnings and cash flows by approximately \$0.4 million annually on the total of the outstanding balances on our Facility as of September 30, 2018.

### **Item 4. Controls and Procedures**

#### **Evaluation of Disclosure Controls and Procedures**

Our management has evaluated, under the supervision and with the participation of our Chief Executive Officer, President and Chief Financial Officer, the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act), and has concluded that as of the end of the period covered by this report, our disclosure controls and procedures were effective to give reasonable assurance that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms and is accumulated and communicated to our management, including our Chief Executive Officer, President, and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosures.

#### **Changes in Internal Control Over Financial Reporting**

There were no changes in our internal control over financial reporting during the quarter ended September 30, 2018 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

**Table of Contents**

**PART II. OTHER INFORMATION**

**Item 1. Legal Proceedings**

We are not involved in any material litigation nor, to our knowledge, is any material litigation threatened against us.

**Item 1A. Risk Factors**

Except to the extent updated below or previously updated or to the extent additional factual information disclosed elsewhere in this Quarterly Report on Form 10-Q relates to such risk factors (including, without limitation, the matters discussed in Part I, Item 2 Management's Discussion and Analysis of Financial Condition and Results of Operations ), there have been no material changes to the risk factors disclosed in the Company's Annual Report on Form 10-K for the year ended December 31, 2017.

**Item 2. Unregistered Sale of Equity Securities and Use of Proceeds**

(a) Not Applicable.

(b) Not Applicable.

(c) Not Applicable.

**Item 3. Defaults Upon Senior Securities**

None.

**Item 4. Mine Safety Disclosures**

Not Applicable.

**Item 5. Other Information**

None.

**Item 6. Exhibits**

**Exhibit**

Number	Exhibit Description
10.1	<u>Fifth Amended and Restated Senior Credit Agreement, dated as of October 19, 2018, among Terreno Realty LLC, KeyBank National Association, both individually as a Lender and as Administrative Agent, KeyBanc Capital Markets, as joint lead arranger, MUFG Union Bank, N.A., as co-syndication agent and joint lead arranger, PNC Bank, National Association, as co-syndication agent, PNC Capital Markets LLC, as joint lead arranger, Regions Bank, as co-syndication agent, Regions Capital Markets, as joint lead arranger and the several banks, financial institutions and other entities which may from time to time become parties as additional Lenders (previously filed as Exhibit 10.1 to the Company's Current Report on Form 8-K on October 25, 2018 and incorporated herein by reference).</u>
31.1*	<u>Rule 13a-14(a)/15d-14(a) Certification dated November 1, 2018.</u>
31.2*	<u>Rule 13a-14(a)/15d-14(a) Certification dated November 1, 2018.</u>
31.3*	<u>Rule 13a-14(a)/15d-14(a) Certification dated November 1, 2018.</u>
32.1**	<u>18 U.S.C. § 1350 Certification dated November 1, 2018.</u>
32.2**	<u>18 U.S.C. § 1350 Certification dated November 1, 2018.</u>
32.3**	<u>18 U.S.C. § 1350 Certification dated November 1, 2018.</u>
101*	The following materials from Terreno Realty Corporation's Quarterly Report on Form 10-Q for the quarter ended September 30, 2018, formatted in XBRL (eXtensible Business Reporting Language): (i) Consolidated Balance Sheets, (ii) Consolidated Statements of Operations, (iii) Consolidated Statements of Comprehensive Income (Loss), (iv) Consolidated Statement of Equity, (v) Consolidated Statements of Cash Flows and (vi) Condensed Notes to Consolidated Financial Statements.

\* Filed herewith.

\*\* Furnished herewith.

Table of Contents

**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Terreno Realty Corporation

November 1, 2018

By: /s/ W. Blake Baird  
W. Blake Baird  
Chairman and Chief Executive Officer

November 1, 2018

By: /s/ Michael A. Coke  
Michael A. Coke  
President

November 1, 2018

By: /s/ Jaime J. Cannon  
Jaime J. Cannon  
Chief Financial Officer