

Edgar Filing: PUBLIC STORAGE INC /CA - Form 10-Q

PUBLIC STORAGE INC /CA  
Form 10-Q  
November 09, 2006

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, 2006

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: 1-8389  
-----

PUBLIC STORAGE, INC.  
-----

(Exact name of registrant as specified in its charter)

California

95-3551121

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

(I.R.S. Employer Identification Number)

701 Western Avenue, Glendale, California

91201-2349

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

(Zip Code)

Registrant's telephone number, including area code: (818) 244-8080.  
-----

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for at least the past 90 days.

Yes  No

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

Large Accelerated Filer  Accelerated Filer  Non-accelerated Filer

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

Yes  No

Indicate the number of shares outstanding of the registrant's common stock, as

# Edgar Filing: PUBLIC STORAGE INC /CA - Form 10-Q

of November 7, 2006:

Common Stock, \$.10 par value per share - 170,174,335 shares

## PUBLIC STORAGE, INC.

### INDEX

	Pages
PART I. FINANCIAL INFORMATION -----	
Item 1. Financial Statements (Unaudited)	
Condensed Consolidated Balance Sheets at September 30, 2006 and December 31, 2005	1
Condensed Consolidated Statements of Income for the Three and Nine Months Ended September 30, 2006 and 2005	2 - 3
Condensed Consolidated Statement of Shareholders' Equity for the Nine Months Ended September 30, 2006	4
Condensed Consolidated Statements of Cash Flows for the Nine Months Ended September 30, 2006 and 2005	5 - 6
Notes to Condensed Consolidated Financial Statements	7 - 41
Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations	42 - 80
Item 3. Quantitative and Qualitative Disclosures about Market Risk	80 - 81
Item 4. Controls and Procedures	82
PART II. OTHER INFORMATION (Items 3 and 5 are not applicable) -----	
Item 1. Legal Proceedings	83
Item 1A. Risk Factors	83 - 89
Item 2. Unregistered Sales of Equity Securities and Use of Proceeds	89
Item 4. Submission of Matters to a Vote of Security Holders	89 - 90
Item 6. Exhibits	90

Edgar Filing: PUBLIC STORAGE INC /CA - Form 10-Q

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

	September 2006
	----- (Unaudit
ASSETS	
Cash and cash equivalents.....	\$ 124
Real estate facilities, at cost:	
Land.....	3,605
Buildings.....	7,570
	-----
	11,175
Accumulated depreciation.....	(1,655)
	-----
	9,519
Construction in process.....	131
	-----
	9,651
Investment in real estate entities.....	301
Goodwill (Note 2).....	174
Intangible assets, net (Note 2).....	432
Other assets.....	170
	-----
Total assets.....	\$ 10,854
	=====
LIABILITIES AND SHAREHOLDERS' EQUITY	
Notes payable.....	\$ 1,426
Debt to joint venture partner.....	37
Preferred stock called for redemption.....	143
Accrued and other liabilities.....	344
	-----
Total liabilities.....	1,951
Minority interest:	
Preferred partnership interests.....	325
Other partnership interests.....	174
Commitments and contingencies (Note 16)	
Shareholders' equity:	
Cumulative Preferred Stock, \$0.01 par value, 50,000,000 shares authorized, 1,715,486 shares issued (in series) and outstanding, (1,698,336 at December 31, 2005) at liquidation preference.....	2,927
Common Stock, \$0.10 par value, 200,000,000 shares authorized, 168,986,243 shares issued and outstanding (128,089,563 at December 31, 2005).....	16
Equity Stock, Series A, \$0.01 par value, 200,000,000 shares authorized, 8,744.193 shares issued and outstanding.....	
Paid-in capital.....	5,659
Cumulative net income.....	3,513
Cumulative distributions paid.....	(3,702)
Accumulated other comprehensive loss.....	(11
	-----
Total shareholders' equity.....	8,403
	-----
Total liabilities and shareholders' equity.....	\$ 10,854

Edgar Filing: PUBLIC STORAGE INC /CA - Form 10-Q

See accompanying notes.

1

PUBLIC STORAGE, INC.  
 CONDENSED CONSOLIDATED STATEMENTS OF INCOME  
 (Amounts in thousands, except per share amounts)

(Unaudited)

	Three Months Ended September 30,	
	2006	2005
	-----	-----
Revenues:		
Rental income:		
Self-storage facilities.....	\$ 328,841	\$ 241,100
Commercial properties.....	3,408	3,408
Containerized storage facilities.....	4,353	4,353
Ancillary operations.....	22,106	22,106
Interest and other income.....	12,651	12,651
	-----	-----
	371,359	273,618
	-----	-----
Expenses:		
Cost of operations (excluding depreciation and amortization below):		
Self-storage facilities.....	109,216	81,100
Commercial properties.....	1,497	1,497
Containerized storage facilities.....	3,907	3,907
Ancillary operations.....	13,447	13,447
Depreciation and amortization.....	113,531	113,531
General and administrative.....	36,242	36,242
Interest expense.....	9,323	9,323
	-----	-----
	287,163	157,040
	-----	-----
Income from continuing operations before asset impairment charge, gain (loss) on disposition of real estate assets, equity in earnings of real estate entities, foreign currency exchange loss, income from derivatives and minority interest in income.....	84,196	121,100
Asset impairment charge due to casualty loss (Note 2).....	-	-
Gain (loss) on disposition of real estate assets.....	756	756
Equity in earnings of real estate entities (Note 6).....	2,618	2,618
Foreign currency exchange loss.....	(172)	(172)
Income from derivatives, net.....	32	32
Minority interest in income:		
Preferred partnership interests:		
Based on ongoing distributions paid.....	(5,403)	(5,403)
Allocation of redemption costs (Note 11).....	-	-
Other partnership interests.....	(3,187)	(3,187)
	-----	-----
Income from continuing operations.....	78,840	112,814
Cumulative effect of change in accounting principle (Note 14).....	-	-
Discontinued operations (Note 4).....	2,341	2,341

Edgar Filing: PUBLIC STORAGE INC /CA - Form 10-Q

Net income.....	\$ 81,181	\$ 12
-----		
Net income allocation:		
-----		
Allocable to preferred shareholders:		
Based on distributions paid.....	\$ 60,265	\$ 4
Based on redemptions of preferred stock (Note 2).....	21,643	
Allocable to Equity Stock, Series A.....	5,356	
Allocable to common shareholders.....	(6,083)	7
	-----	-----
	\$ 81,181	\$ 12
=====		
Net income (loss) per common share - basic		
Continuing operations.....	\$ (0.06)	\$
Discontinued operations.....	0.02	
	-----	-----
	\$ (0.04)	\$
=====		
Net income (loss) per common share - diluted		
Continuing operations.....	\$ (0.06)	\$
Discontinued operations.....	0.02	
	-----	-----
	\$ (0.04)	\$
=====		

See accompanying notes.

2

PUBLIC STORAGE, INC.  
CONDENSED CONSOLIDATED STATEMENTS OF INCOME  
(Amounts in thousands, except per share amounts)

(Unaudited)

(Continued)

	Three Months Ended September 30,	
	2006	20
	-----	-----
Net income per depository share of Equity Stock, Series A (basic and diluted).....	\$ 0.61	\$
	=====	=====
Basic weighted average common shares outstanding.....	145,387	12
	=====	=====
Diluted weighted average common shares outstanding.....	145,387	12
	=====	=====
Weighted average shares of Equity Stock, Series A (basic and diluted)...	8,744	
	=====	=====

Edgar Filing: PUBLIC STORAGE INC /CA - Form 10-Q

See accompanying notes.

3

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

(Unaudited)

	Cumulative Preferred Stock	Common Stock
	-----	-----
Balance at December 31, 2005.....	\$ 2,498,400	\$ 12,809
Issuance of cumulative preferred stock:		
Series H (4,200 shares).....	105,000	-
Series I (20,700 shares).....	517,500	-
Series K (18,400 shares).....	460,000	-
Redemption of cumulative preferred stock:		
Series R (20,400 shares).....	(510,000)	-
Series S (5,750 shares).....	(143,750)	-
Issuance of common stock in connection with:		
Exercise of employee stock options (1,875,173 shares)..	-	188
Vesting of restricted stock (102,364 shares) .....	-	10
Merger with Shurgard Storage Centers, Inc. (38,913,187 shares) .....	-	3,891
Acquisition of minority interests (5,956 shares) .....	-	1
Stock-based compensation expense (Note 14) .....	-	-
Net income.....	-	-
Cash distributions:		
Cumulative preferred stock (Note 12).....	-	-
Equity Stock, Series A (\$1.845 per depositary share)...	-	-
Common Stock (\$1.50 per share).....	-	-
Accumulated other comprehensive loss:		
Foreign currency translation adjustments.....	-	-
Balance at September 30, 2006.....	\$ 2,927,150	\$ 16,899
	=====	=====

	Cumulative Distributions	Accumulated Other Comprehensive Loss
	-----	-----
Balance at December 31, 2005.....	\$ (3,314,137)	\$ -
Issuance of cumulative preferred stock:		

Edgar Filing: PUBLIC STORAGE INC /CA - Form 10-Q

Series H (4,200 shares).....	-	-
Series I (20,700 shares).....	-	-
Series K (18,400 shares).....	-	-
Redemption of cumulative preferred stock:		
Series R (20,400 shares).....	-	-
Series S (5,750 shares).....	-	-
Issuance of common stock in connection with:		
Exercise of employee stock options (1,875,173 shares)..	-	-
Vesting of restricted stock (102,364 shares) .....	-	-
Acquisition of Shurgard Storage Centers (38,913,187 shares) .....	-	-
Acquisition of minority interests (5,956 shares) .....	-	-
Stock-based compensation expense (Note 14) .....	-	-
Net income.....	-	-
Cash distributions:		
Cumulative preferred stock (Note 12).....	(159,256)	-
Equity Stock, Series A (\$1.845 per depositary share)...	(16,068)	-
Common Stock (\$1.50 per share).....	(213,281)	-
Accumulated other comprehensive loss:		
Foreign currency translation adjustments.....	-	(11,269)
Balance at September 30, 2006.....	\$ (3,702,742)	\$ (11,269)
	=====	=====

See accompanying notes.

4

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

(Unaudited)

	For the Nine Months Ended September 30, 2006
	----- 2006 -----
Cash flows from operating activities:	
Net income.....	\$ 324,259
Adjustments to reconcile net income to net cash provided by operating activities:	
Amortization of note premium (Note 8).....	(968)
Excess of effective interest over cash interest paid on debt to joint venture partner (Note 9) .....	130
Gain on sales of real estate facilities, net, including discontinued operations.....	(3,592)
Real estate impairment associated with casualty losses (Note 2).....	-
Depreciation and amortization, including discontinued operations.....	212,256
Expense of capitalized development project costs .....	9,319

Edgar Filing: PUBLIC STORAGE INC /CA - Form 10-Q

Equity in earnings of real estate entities.....	(9,208)
Foreign currency exchange loss.....	172
Income from derivatives, net.....	(32)
Distributions received from the real estate entities (Note 6).....	15,049
Minority interest in income.....	24,477
Other operating activities.....	10,290
	-----
Total adjustments.....	257,893
	-----
Net cash provided by operating activities.....	582,152
	-----
Cash flows from investing activities:	
Capital improvements to real estate facilities .....	(44,366)
Construction in process.....	(70,903)
Acquisition of minority interests (Note 11).....	(60,799)
Acquisition of real estate facilities.....	(98,954)
Consolidation of partnerships (Note 2).....	3,024
Cash portion of the merger with Shurgard (Note 3).....	(161,284)
Proceeds from sales of real estate and real estate investments.....	11,281
Proceeds from sales of held-to-maturity investments (Note 2).....	8,079
Acquisition of held-to-maturity debt securities.....	-
	-----
Net cash used in investing activities.....	(413,922)
	-----
Cash flows from financing activities:	
Principal payments on notes payable.....	(687,508)
Proceeds from borrowings on European notes payable.....	8,544
Contributions received from European minority interests.....	9,302
Net proceeds from issuances of common stock.....	78,899
Net proceeds from issuances of cumulative preferred stock.....	1,048,945
Repurchases of common stock.....	-
Redemption of cumulative preferred stock.....	(682,500)
Redemption of preferred partnership interests.....	-
Issuance of preferred partnership interests.....	100,000
Distributions paid to shareholders.....	(388,605)
Distributions paid to holders of preferred partnership interests (Note 12).....	(13,652)
Distributions paid to other minority interests.....	(11,037)
Net proceeds from financing through acquisition joint venture (Note 9).....	-
	-----
Net cash used in financing activities.....	(537,612)
	-----
Net (decrease) increase in cash and cash equivalents.....	(369,382)
Cash and cash equivalents at the beginning of the year.....	493,501
	-----
Cash and cash equivalents at the end of the period.....	\$ 124,119
	=====

See accompanying notes.

5

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

(Unaudited)



Edgar Filing: PUBLIC STORAGE INC /CA - Form 10-Q

(Continued)

	For the Nine Months Ended September 30, 2006
Supplemental schedule of non-cash investing and financing activities:	
Real estate acquired in exchange for assumption of mortgage note.....	\$ (4,590)
Mortgage note assumed in connection with acquisition of real estate.....	4,590
Merger with Shurgard (Note 3):	
Real estate facilities.....	(5,070,528)
Intangible assets.....	(483,107)
Other Assets.....	(100,411)
Accrued and other liabilities.....	162,730
Minority interest.....	144,351
Debt.....	1,999,535
Common Stock.....	3,891
Paid-in capital.....	3,182,255
Consolidation of entities pursuant to Emerging Issues Task Force Topic 04-5 (Note 2):	
Minority interest.....	3,963
Real estate facilities.....	(22,459)
Investments.....	20,846
Other Assets.....	(167)
Accrued and Other Liabilities.....	841
Retirement of common stock and Equity Stock, Series A, received as a distribution from affiliated entities (Note 2):	
Common stock.....	-
Paid-in capital.....	-
Investment in real estate entities.....	-
Acquisition of minority interests in Consolidated Joint Venture in exchange for debt (Note 11):	
Minority Interest - other partnership interests.....	-
Real estate facilities.....	-
Debt to related party.....	-
Increase in debt to joint venture partner (Note 9)	
Debt to joint venture partner.....	1,386
Other assets.....	(1,386)
Foreign currency adjustment	
Real estate facilities.....	20,849
Construction in process.....	643
Notes payable.....	(10,223)
Equity.....	(11,269)

See accompanying notes.

6

PUBLIC STORAGE, INC.  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
September 30, 2006  
(Unaudited)

1. Description of the Business

## Edgar Filing: PUBLIC STORAGE INC /CA - Form 10-Q

Public Storage, Inc. (referred to herein as "the Company", "we", "us" or "our") is a California corporation, which was organized in 1980. We are a fully integrated, self-administered and self-managed real estate investment trust ("REIT") whose principal business activities include the acquisition, development, ownership and operation of self-storage facilities which offer storage spaces for lease, generally on a month-to-month basis, for personal and business use. In addition, we have (i) interests in commercial properties, containing commercial and industrial rental space, (ii) interests in facilities that lease storage containers, and (iii) ancillary operations comprised principally of reinsurance of policies against losses to goods stored by our self-storage tenants, retail sales and truck rentals at our self-storage locations. As described more fully in Note 3, "Merger with Shurgard," on August 22, 2006, the Company merged with Shurgard Storage Centers, Inc., ("Shurgard").

At September 30, 2006, we had direct and indirect equity interests in 2,003 self-storage facilities located in 38 states operating under the "Public Storage" name, and 160 self-storage facilities located in seven European nations which operate under the "Shurgard Storage Centers" name. We also have direct and indirect equity interests in approximately 19 million net rentable square feet of commercial space located in 10 states in the U.S.

### 2. Summary of Significant Accounting Policies

-----

#### Basis of Presentation

-----

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles in the United States ("GAAP") for interim financial information and the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by United States generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting of normal and recurring adjustments) considered necessary for a fair presentation have been reflected in these unaudited condensed consolidated financial statements. Operating results for the three and nine months ended September 30, 2006 are not necessarily indicative of the results that may be expected for the year ended December 31, 2006. The accompanying unaudited condensed consolidated financial statements should be read together with the consolidated financial statements and related notes included in the Company's Annual Report on Form 10-K for the year ended December 31, 2005.

Certain amounts previously reported have been reclassified to conform to the September 30, 2006 presentation. In previous presentations, intangible assets were reported separately from goodwill on the Company's consolidated balance sheet. We have now reclassified the intangible assets to goodwill (see "Goodwill and Intangible Assets" below). In previous presentations, net income from our truck rental, merchandise sales, and property management operations were included on a net basis in "Interest and other income" in our consolidated statements of income. In our current presentation, revenues with respect to each of these operations, along with revenues from our tenant reinsurance operations, are included under the caption "Revenues: Ancillary operations" and the related cost of operations are included in "Expenses: Cost of operations - Ancillary operations" on our accompanying condensed consolidated statements of income. Certain reclassifications have also been made from previous presentations as a result of discontinued operations (See Note 4).

# Edgar Filing: PUBLIC STORAGE INC /CA - Form 10-Q

PUBLIC STORAGE, INC.  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
September 30, 2006  
(Unaudited)

## Consolidation Policy

Entities in which we have an interest are first evaluated to determine whether, in accordance with the provisions of the Financial Accounting Standards Board's Interpretation No. 46R, "Consolidation of Variable Interest Entities," they represent Variable Interest Entities. Variable Interest Entities in which we are the primary beneficiary are consolidated. Entities that are not Variable Interest Entities that we control are consolidated. For purposes of determining control, when we are the general partner, we are considered to control the partnership unless the limited partners possess substantial "kick-out" or "participative" rights as defined in Emerging Issues Task Force Statement 04-5 - "Determining whether a general partner or the general partners as a group, controls a limited partnership or similar entity when the limited partners have certain rights" ("EITF 04-5"). All significant intercompany balances and transactions have been eliminated.

In accordance with the guidance of EITF 04-5, effective January 1, 2006 we commenced consolidating the accounts of three partnerships that we previously accounted for on the equity method. Our investment in these entities totaling \$20,846,000 was allocated to the real estate facilities, cash, other assets, liabilities, and minority interests of these entities as described in the table below (amounts in thousands).

	Total
Real estate facilities.....	\$ 22,459
Cash.....	3,024
Other assets.....	167
Accrued and other liabilities	(841)
Minority interest .....	(3,963)
	-----
	\$ 20,846
	=====

We have determined that we have variable interest entities that we are the primary beneficiaries of that we acquired an interest in as a result of our merger with Shurgard (see Note 3). The accounts of the entities we control along with the accounts of the variable interest entities that we are the primary beneficiary of, (collectively, the "Consolidated Entities") are included in our consolidated financial statements along with those of the Company. Collectively, the Company and the Consolidated Entities own a total of 2,172 real estate facilities, consisting of 2,003 self-storage facilities in the United States (of which 487 were acquired in the Shurgard merger), 160 facilities in Europe which were acquired in the Shurgard merger, three industrial facilities used by the containerized storage operations and six commercial properties.

At September 30, 2006, we had equity investments in five limited partnerships in which we do not have a controlling interest. These limited partnerships collectively own 22 self-storage facilities, which are managed by the Company. In addition, at September 30, 2006, we own approximately 44% of the common equity of PS Business Parks, Inc. ("PSB"), which has interests in approximately 18.2 million net rentable square feet of commercial space at September 30, 2006. Our investment in these limited partnerships and PSB (collectively, the "Unconsolidated Entities") are accounted for using the equity method.

## Edgar Filing: PUBLIC STORAGE INC /CA - Form 10-Q

### Use of Estimates

-----

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

8

PUBLIC STORAGE, INC.  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
September 30, 2006  
(Unaudited)

### Income Taxes

-----

For all taxable years subsequent to 1980, the Company qualified and intends to continue to qualify as a REIT, as defined in Section 856 of the Internal Revenue Code. As a REIT, we are not taxed on that portion of our taxable income which is distributed to our shareholders, provided that we meet certain tests. We believe we will meet these tests during 2006 and, accordingly, no provision for income taxes has been made in the accompanying condensed consolidated financial statements.

### Financial Instruments

-----

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

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

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

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

Included in cash and cash equivalents at September 30, 2006 is \$23,420,000 (\$18,962,000 at December 31, 2005) held by our captive insurance entities. Other assets at September 30, 2006 include investments totaling \$11,759,000 (\$19,838,000 at December 31, 2005) in held-to-maturity Federal government agency securities stated at amortized cost, which approximates fair value. Insurance and other regulations place significant restrictions on our ability to withdraw these funds for purposes other than insurance activities. Other assets at September 30, 2006 also include derivative financial instruments

## Edgar Filing: PUBLIC STORAGE INC /CA - Form 10-Q

totaling \$4,796,000 (none at December 31, 2005) reported at fair value. Accrued and other liabilities at September 30, 2006 include derivative financial instruments totaling \$9,818,000 (none at December 31, 2005) reported at fair value. See Note 10 for further discussion of our derivative financial instruments. The carrying value of our notes payable at September 30, 2006 is \$1,426,533,000 (\$113,950,000 at December 31, 2005) which approximates fair value at those dates.

### Real Estate Facilities

-----

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

### Accounting for Acquisition Joint Venture

-----

In January 2004, we entered into a joint venture partnership with an institutional investor for the purpose of acquiring up to \$125,000,000 of existing self-storage properties in the United States from third parties (the "Acquisition Joint Venture"). The Acquisition Joint Venture is funded entirely with equity consisting of 30% from the Company and 70% from the institutional investor. For a six-month period beginning 54 months after formation, we have

9

PUBLIC STORAGE, INC.  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
September 30, 2006  
(Unaudited)

the right to acquire our partner's interest based upon the market value of the properties. If we do not exercise our option, our partner can elect to purchase our interest in the properties during a six-month period commencing upon expiration of our six-month option period. If our partner fails to exercise its option, the Acquisition Joint Venture will be liquidated and the proceeds will be distributed to the partners according to the joint venture agreement.

We have determined that the Acquisition Joint Venture is not a variable interest entity, and we do not control this entity. Therefore, we do not consolidate the accounts of the Acquisition Joint Venture on our accompanying condensed consolidated financial statements.

During the year ended December 31, 2004, the Acquisition Joint Venture acquired two facilities directly from third parties at an aggregate cost of \$9,086,000. We account for our investment with respect to these facilities using the equity method, with our pro rata share of the income from these facilities recorded as "Equity in earnings of real estate entities" on our accompanying condensed consolidated statements of income. See Note 6 for further discussion of these amounts.

In December 2004, we sold seven facilities to the Acquisition Joint Venture for an aggregate of \$22,993,000. During the first quarter of 2005, we sold an interest in three additional facilities to the Acquisition Joint Venture for an aggregate of approximately \$27,755,000. Due to our continuing interest in

## Edgar Filing: PUBLIC STORAGE INC /CA - Form 10-Q

these facilities and the likelihood that we will exercise our option to acquire our partner's interest, we have accounted for our partner's investment (\$37,214,000 and \$35,697,000 at September 30, 2006 and December 31, 2005, respectively) in these facilities as, in substance, debt financing. Accordingly, our partner's investment with respect to these ten facilities is accounted for as a liability on our accompanying condensed consolidated balance sheets under the caption "Debt to joint venture partner," with our partner's share of operations with respect to these ten facilities accounted for as interest expense on our accompanying condensed consolidated statements of income. On a quarterly basis, we review the fair value of this liability, and to the extent fair value exceeds the carrying value of the liability, an adjustment is made to increase the liability to fair value, and to increase other assets, with the other assets amortized over the remaining period term of the Acquisition Joint Venture. See Note 9 for a discussion of the results of this review.

### Evaluation of Asset Impairment

-----

We evaluate impairment of goodwill annually through a two-step process. In the first step, if the fair value of the reporting unit to which the goodwill applies is equal to or greater than the carrying amount of the assets of the reporting unit, including the goodwill, the goodwill is considered unimpaired and the second step is unnecessary. If, however, the fair value of the reporting unit including goodwill is less than the carrying amount, the second step is performed. In this test, we compute the implied fair value of the goodwill based upon the allocations that would be made to the goodwill, other assets and liabilities of the reporting unit if a business combination transaction were consummated at the fair value of the reporting unit. An impairment loss is recorded to the extent that the implied fair value of the goodwill is less than the goodwill's carrying amount. No impairments of our goodwill were identified in our annual evaluation at December 31, 2005.

We evaluate impairment of long-lived assets on a quarterly basis. We first evaluate these assets for indicators of impairment such as a) a significant decrease in the market price of a long-lived asset, b) a significant adverse change in the extent or manner in which a long-lived asset is being used or in its physical condition, c) a significant adverse change in legal factors or the business climate that could affect the value of the long-lived asset, d) an accumulation of costs significantly in excess of the amount originally projected for the acquisition or construction of the long-lived asset, or e) a current-period operating or cash flow loss combined with a history of operating or cash flow losses or a projection or forecast that demonstrates continuing losses associated with the use of the long-lived asset. When any such indicators of impairment are noted, we compare the carrying value of these assets to the future estimated undiscounted cash flows attributable to these assets. If the asset's recoverable amount is less than the carrying value of the asset, then an impairment charge is booked for the excess of carrying value over the asset's fair value.

10

PUBLIC STORAGE, INC.  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
September 30, 2006  
(Unaudited)

Any long-lived assets which we expect to sell or otherwise dispose of prior to their previously estimated useful life are stated at what we estimate to be the lower of their estimated net realizable value (less cost to sell) or their carrying value. No impairments were identified from our evaluations as of September 30, 2006.

## Edgar Filing: PUBLIC STORAGE INC /CA - Form 10-Q

### Accounting for Stock-Based Compensation

-----

We utilize the Fair Value Method (as defined in Note 14) of accounting for our employee stock options. Restricted stock unit expense is recorded over the relevant vesting period. See Note 14 for a discussion of our accounting with respect to employee stock options and restricted stock units.

### Other Assets

-----

Other assets primarily consists of prepaid expenses, investments in held-to-maturity debt securities (described below), accounts receivable, assets associated with our containerized storage business, merchandise inventory and rental trucks.

Included in depreciation and amortization expense for the three and nine months ended September 30, 2006, is \$1,304,000 and \$3,584,000, respectively, compared to \$1,376,000 and \$5,159,000, respectively, for the same periods in 2005, related to depreciation of other assets.

### Accrued and Other Liabilities

-----

Accrued and other liabilities consist primarily of real and personal property tax accruals, value-added tax ("VAT") with respect to our European operations, prepayments of rents, trade payables, losses and loss adjustment liabilities from our insurance programs (described below), and accrued interest. Prepaid rent totaled \$57,591,000 at September 30, 2006 (\$26,145,000 at December 31, 2005).

STOR-Re Mutual Insurance Company, Inc. ("STOR-Re"), which is consolidated with the Company, was formed in 1994 as an association captive insurance company owned by the Company and affiliates of the Company. STOR-Re provides limited property and liability insurance to the Company and its affiliates for losses incurred during policy periods prior to April 1, 2004, and was succeeded by PS Insurance Company Hawaii, Ltd. ("PSIC-H"), a wholly-owned subsidiary of the Company with respect to these insurance activities for policy periods following March 31, 2004. We also utilize other insurance carriers to provide property and liability insurance coverage in excess of STOR-Re's and PSIC-H's limitations which are described in Note 16. STOR-Re and PSIC-H accrue liabilities for covered losses and loss adjustment expense, which at September 30, 2006 totaled \$32,690,000 (\$32,797,000 at December 31, 2005) with respect to insurance provided to the Company and its affiliates.

Liabilities for losses and loss adjustment expenses include an amount we determine from loss reports and individual cases and an amount, based on recommendations from an independent actuary that is a member of the American Academy of Actuaries using a frequency and severity method, for losses incurred but not reported. Determining the liability for unpaid losses and loss adjustment expense is based upon estimates. While we believe that the amount is adequate, the ultimate loss may be in excess of or less than the amounts provided. See Note 16 for a discussion of our maximum aggregate annual exposure, assuming the occurrence of multiple significant events. The methods for making such estimates and for establishing the resulting liability are reviewed quarterly.

## Edgar Filing: PUBLIC STORAGE INC /CA - Form 10-Q

### NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS September 30, 2006 (Unaudited)

PS Insurance Company, Ltd ("PSIC"), a wholly-owned subsidiary of the Company, reinsured policies against claims for losses to goods stored by tenants in our self-storage facilities for policy periods prior to March 31, 2004. PSIC-H succeeded PSIC with respect to these tenant re-insurance activities effective April 1, 2004. Prior to January 1, 2006, both of these entities utilize third-party insurance coverage for losses from any individual event that exceeds a loss of \$500,000, to a maximum of \$10,000,000. Commencing January 1, 2006, PSIC-H covers losses up to \$1,500,000 with third party insurers covering the next \$9,000,000 from any individual event. Losses below the third-party insurers' deductible amounts are accrued as cost of operations for the tenant re-insurance operations. Losses exceeding the third-party insurers' limit are the responsibility of PSIC-H. See Note 16 for a discussion of our reinsured policies outstanding at September 30, 2006.

The accrued liability for losses and loss adjustment expense with respect to tenant insurance activities totaled \$3,261,000 at September 30, 2006 (\$4,773,000 at December 31, 2005).

#### Goodwill and Intangible Assets -----

Goodwill represents the excess of acquisition cost over the fair value of net tangible and identifiable intangible assets acquired in business combinations. Each business combination from which our goodwill arose was for the acquisition of single businesses and accordingly, the allocation of our goodwill to our business segments is based directly on such acquisitions. Our goodwill has an indeterminate life in accordance with the provisions of Statement of Financial Accounting Standards No. 142 ("SFAS 142").

In prior periods, intangible assets (original acquisition cost of \$165,000,000 and net book value of \$98,081,000 at December 31, 2005) were presented on our consolidated balance sheets. For all periods presented herein, we have reclassified this intangible asset to goodwill on our accompanying condensed consolidated balance sheets and, in accordance with the provisions of SFAS 142 as applied to the reclassification effective April 1, 2006, we ceased amortization.

Included in depreciation and amortization expense for the nine months ended September 30, 2006 is \$1,651,000 (none for the three months ended September 30, 2006) related to the amortization of our intangibles and goodwill, as compared to \$1,651,000 and \$4,953,000 for the three and nine months ended September 30, 2005, respectively. Goodwill is reported net of accumulated amortization of \$85,085,000 and \$83,434,000 at September 30, 2006 and December 31, 2005, respectively, on our accompanying condensed consolidated balance sheets.

As a result of the merger with Shurgard (Note 3), we acquired finite-lived intangible assets, which were valued in our purchase accounting analysis, represented by the value of the storage tenants in place of \$428,643,000 and by the land leases with rent payments that are below market, valued at \$35,639,000. The tenant intangible assets are being amortized relative to the expected future benefit of the tenants in place to each period. Also as a result of the merger with Shurgard, we acquired indefinite-lived intangible assets, which were valued in our purchase accounting analysis, represented by the value of the Shurgard tradename of \$18,825,000. We continue to use the Shurgard tradename in Europe. In accordance with the provisions of SFAS 142, we are not amortizing these indefinite-lived intangible assets and are analyzing them on an annual basis for recoverability. Amortization expense of \$50,626,000



## Edgar Filing: PUBLIC STORAGE INC /CA - Form 10-Q

was recorded for our finite-lived intangible assets for the three months ended September 30, 2006. The estimated annual amortization expense for our finite-lived intangible assets for the current year and each of the next three years ending December 31 is as follows:

2006 (after September 30, 2006)	\$ 94,800,000
2007	194,700,000
2008	55,898,000
2009	33,819,000

12

PUBLIC STORAGE, INC.  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
September 30, 2006  
(Unaudited)

### Revenue and Expense Recognition

-----

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

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

Cost of operations, general and administrative expense, interest expense, as well as television, yellow page, and other advertising expenditures are expensed as incurred. Accordingly, the amounts incurred in an interim period may not be indicative of the amounts to be incurred during a full year. Television, yellow page, and other advertising expenses totaled \$7,103,000 and \$24,726,000 for the three and nine months ended September 30, 2006, respectively, and \$7,486,000 and \$24,049,000, respectively, for the same periods in 2005. Television, yellow page, and other advertising expenses totaled \$1,075,000 for the three and nine months ended September 30, 2006 for our European operations.

### Foreign Exchange Translation Policy

-----

The local currency is the functional currency for our European subsidiaries. Assets and liabilities are translated at end-of-period rates while revenues and expenses are translated at average rates in effect during the period. Equity is translated at historical rates and the resulting cumulative translation adjustments are included as a component of accumulated other comprehensive income (loss) until the translation adjustments are realized.

### Derivative Financial Instruments

-----

In connection with the Company's merger with Shurgard, we have acquired certain preexisting derivative financial instruments held by Shurgard (the "Shurgard Derivatives"), including interest rate caps, interest rate swaps,

## Edgar Filing: PUBLIC STORAGE INC /CA - Form 10-Q

cross-currency swaps and foreign currency forward contracts. We do not intend to use derivative financial instruments for speculative or trading purposes.

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

As of September 30, 2006, and for the three and nine month periods then ended, none of the Shurgard Derivatives were considered effective hedges because we believe it is not highly likely that the debt and the related derivative instruments will remain outstanding for their entire contractual period. Accordingly, all changes in fair value are reflected in earnings, along with the related cash flows from these instruments, under "net income from derivatives" on our condensed consolidated statement of income. For the three and nine months ended September 30, 2006, net income from derivatives was comprised of a change in value of the related instruments representing a gain of \$913,000, less \$881,000 in net payments incurred during the period under the underlying instruments.

13

PUBLIC STORAGE, INC.  
 NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
 September 30, 2006  
 (Unaudited)

Other Comprehensive Income (Loss)  
 -----

Our comprehensive income (loss) is as follows:

	For the Three Months Ended		For the
	September 30, 2006	September 30, 2005	September 2006
Net income.....	\$ 81,181	\$ 128,344	\$ 324,2
Accumulated other comprehensive loss:			
Foreign currency translation adjustments.....	(11,269)	-	(11,2
Total comprehensive income.....	\$ 69,912	\$ 128,344	\$ 312,9

The foreign currency translation adjustment represents the net currency translation adjustment gains and losses related to our European subsidiaries acquired in the merger with Shurgard measured from the date of the merger through September 30, 2006. Amounts are presented net of minority interests.

Environmental Costs  
 -----

Our policy is to accrue environmental assessments and estimated remediation costs when it is probable that such efforts will be required and the related costs can be reasonably estimated. Our current practice is to conduct

## Edgar Filing: PUBLIC STORAGE INC /CA - Form 10-Q

environmental investigations in connection with property acquisitions. Although there can be no assurance, we are not aware of any environmental contamination of any of our facilities, which individually or in the aggregate would be material to our overall business, financial condition, or results of operations.

### Net Income per Common Share

-----

Distributions paid to the holders of our Cumulative Preferred Stock totaling \$60,265,000 and \$43,726,000 for the three months ended September 30, 2006 and 2005, respectively, have been deducted from net income to arrive at net income allocable to our common shareholders (dividends paid to holders of our Cumulative Preferred Stock totaled \$159,256,000 and \$126,286,000 for the nine months ended September 30, 2006 and 2005, respectively).

Emerging Issues Task Force ("EITF") Topic D-42, "The Effect on the Calculation of Earnings per Share for the Redemption or the Induced Conversion of Preferred Stock" provides, among other things, that any excess of (1) the fair value of the consideration transferred to the holders of preferred stock redeemed over (2) the carrying amount of the preferred stock should be subtracted from net earnings to determine net earnings available to common stockholders in the calculation of earnings per share. At the July 31, 2003 meeting of the EITF, the Securities and Exchange Commission ("SEC") Observer clarified that for purposes of applying EITF Topic D-42, the carrying amount of the preferred stock should be reduced by the issuance costs of the preferred stock, regardless of where in the stockholders' equity section those costs were initially classified on issuance.

On September 28, 2006, we redeemed our 8.00% Series R Preferred Stock for \$510,000,000 plus accrued and unpaid dividends. In addition, on September 26, 2006, we called for redemption our 7.875% Series S Preferred Stock for \$143,750,000 plus accrued and unpaid dividends. The Series S was redeemed on October 31, 2006. As a result of these redemptions, there was an additional allocation to the preferred shareholders of approximately \$21,643,000 (\$0.16 per common share, based upon the weighted average diluted shares during the nine months ended September 30, 2006) during the three and nine months ended September 30, 2006 (none and \$1,904,000 for the same periods in 2005) from the application of EITF Topic D-42. It is our policy to record such allocations at the time the securities are called for redemption.

14

PUBLIC STORAGE, INC.  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
September 30, 2006  
(Unaudited)

Net income allocated to our common shareholders has been further allocated among our two classes of common stock; our regular common stock and our Equity Stock, Series A. The allocation among each class was based upon the two-class method. Under the two-class method, earnings per share for each class of common stock are determined according to dividends declared (or accumulated) and participation rights in undistributed earnings. Under the two-class method, the Equity Stock, Series A, was allocated net income of \$5,356,000 and \$5,356,000 for three months ended September 30, 2006 and 2005, respectively, and \$16,068,000 and \$16,087,000 for the nine months ended September 30, 2006 and 2005, respectively. A loss of \$6,083,000 and income of \$79,262,000 for the three months ended September 30, 2006 and 2005, respectively, was allocated to the regular common shareholders (income of \$127,292,000 and \$188,744,000 for the nine months ended September 30, 2006 and 2005, respectively).

## Edgar Filing: PUBLIC STORAGE INC /CA - Form 10-Q

Basic net income per share is computed using the weighted average common shares outstanding (prior to the dilutive impact of stock options and restricted stock units outstanding). Diluted net income per common share is computed using the weighted average common shares outstanding (adjusted for the dilutive impact of stock options and restricted stock units outstanding). The stock options and restricted stock units were anti-dilutive in the three months ended September 30, 2006 and were not reflected in diluted net income per common share for that period. Weighted average common shares excludes shares owned by the Consolidated Entities as described in Note 12 for all periods presented, as these shares of common stock are eliminated in consolidation.

### Recently Issued Accounting Standards

-----

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

### 3. Merger with Shurgard

-----

On August 22, 2006, the Company merged with Shurgard, a REIT which owned 487 self-storage facilities in the United States and 160 self-storage facilities in Europe. We believe this merger will provide a number of strategic and financial benefits and growth opportunities for us by solidifying our position as the largest owner and operator of self-storage facilities in the U.S., enhancing access to capital, eliminating duplicative general and administrative expenses and improving cost efficiencies, increasing growth opportunities and providing greater geographic and financial diversification. The operations of Shurgard reside primarily within our existing Self-storage - Domestic segment, and have resulted in a new segment, Self-storage - Europe.

Under the terms of the agreement, Shurgard shareholders received 0.82 shares of Public Storage common stock for each share of Shurgard common stock they owned.

15

PUBLIC STORAGE, INC.  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
September 30, 2006  
(Unaudited)

Total consideration for the merger approximated \$5,346,965,000, comprised of i) the issuance of 38.9 million shares of Public Storage common stock (valued at approximately \$3,116,850,000 based upon the average of Public Storage's share closing price for five days before, the day of and five days after the acquisition announcement date of March 7, 2006), ii) the assumption of

## Edgar Filing: PUBLIC STORAGE INC /CA - Form 10-Q

Shurgard's domestic and European notes payable and capital leases with a fair value of approximately \$1,395,763,000 of which \$67,275,000 was repaid following the merger iii) the assumption of Shurgard's line of credit totaling \$603,772,000, which was repaid following the merger, iv) the issuance of vested common stock options in exchange for Shurgard stock options, with an estimated intrinsic value of approximately \$69,296,000, and v) \$161,284,000 in cash, comprised of \$137,916,000 to redeem Shurgard's outstanding preferred stock at liquidation value, and approximately \$49,404,000 in direct costs of the merger, less \$20,036,000 in cash held by Shurgard at the date of the merger.

We have allocated this aggregate purchase price to the tangible and intangible net assets, as follows (amounts in thousands):

Operating real estate facilities	\$ 4,979,859
Construction in process	90,669
Intangible assets	483,107
Other assets	100,411
Accrued and other liabilities	(162,730)
Minority interest	(144,351)
	-----
Total allocated Purchase Price to net assets acquired	\$ 5,346,965

Intangible assets consist of the estimated value of Shurgard's existing tenants in place, the estimated value of Shurgard's existing land leases, and the estimated value of Shurgard's tradename, which we expect to continue to use in Europe. Each intangible, except the Shurgard tradename, have finite lives. See Note 2 for further discussion of the amortization method with respect to the intangible assets acquired in the merger with Shurgard.

The results of operations of Shurgard have been included in our condensed consolidated financial statements since the merger date of August 22, 2006. The unaudited pro forma data presented below assumes that the merger occurred as of the beginning of the respective periods, and includes pro forma adjustments to i) increase depreciation expense to reflect our book basis for the buildings acquired, ii) increase amortization expense to reflect the intangible assets acquired in the merger, iii) decrease interest income and increase income allocated to preferred shareholders to reflect the financing of the merger with cash on hand and the proceeds from preferred stock, and iv) decrease the historical general and administrative expense of Shurgard that is expected to be eliminated as a result of the merger. The unaudited pro forma results have been prepared for comparative purposes only and do not purport to be indicative of the results of operations that would have occurred had the merger been consummated at the beginning of the periods presented.

16

PUBLIC STORAGE, INC.  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
September 30, 2006  
(Unaudited)

Three Months Ended	September 30,	Nine Months Ended	September 30,
2006	2005	2006	2005
-----		-----	
(Amounts in thousands, except per share data)			

Edgar Filing: PUBLIC STORAGE INC /CA - Form 10-Q

Revenues.....	\$437,877	\$396,386	\$1,271,171	\$1,139,762
Net income.....	\$ 23,305	\$ 27,120	\$ 153,501	\$ 106,731
Loss per common share:				
Basic.....	\$ (0.38)	\$ (0.18)	\$ (0.38)	\$ (0.38)
Diluted.....	\$ (0.38)	\$ (0.18)	\$ (0.38)	\$ (0.38)

4. Discontinued Operations  
-----

We segregate all of our disposed components that have operations that (i) can be distinguished from the rest of the entity and (ii) will be eliminated from the ongoing operations of the entity in a disposal transaction.

Since January 1, 2002, we closed a total of 43 containerized storage facilities that were determined to be non-strategic (the "Closed Facilities"). As the decision was made to close each facility, the related assets were evaluated for recoverability and asset impairment charges were recorded for the excess of these assets' net book value over their fair value (less costs to sell), determined based upon recent selling prices for similar assets. No asset impairment or lease termination charges were recorded for these facilities during the three or nine months ended September 30, 2006 and 2005.

During the first quarter of 2005, we sold the non-real estate assets of six of the Closed Facilities, resulting in a gain on sale of approximately \$1,143,000.

During July 2005, in an eminent domain proceeding, one of our self-storage facilities located in the Portland, Oregon market was condemned. We received the proceeds, totaling \$6,590,000, from the disposal of this facility during the third quarter of 2005 and recorded a gain on sale of \$5,180,000.

During the first quarter of 2006, in an eminent domain proceeding, one of our self-storage facilities located in the Seattle, Washington market was condemned. We received the proceeds from the condemnation of approximately \$4,257,000 in July 2006, and recorded a gain on disposition of approximately \$2,370,000 in the third quarter of 2006.

Collectively, the aforementioned facilities in Portland and Seattle are referred to hereinafter as "the Eminent Domain Facilities". The operations of these facilities prior to their disposition are classified as "discontinued operations" for all periods presented on our condensed consolidated statements of income and included under "Eminent Domain Facilities" in the table below.

17

PUBLIC STORAGE, INC.  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
September 30, 2006  
(Unaudited)

The following table summarizes the historical operations of each component of our discontinued operations:

Discontinued Operations:  
-----

Three Months Ended

Nine Months Ended

Edgar Filing: PUBLIC STORAGE INC /CA - Form 10-Q

	September 30,		September 30,	
	2006	2005	2006	2005
	(Amounts in thousands)			
Rental income (a):				
Eminent Domain Facilities.....	\$ 1	\$ 281	\$ 193	\$ 792
Closed Facilities.....	-	-	-	95
Total rental income.....	1	281	193	887
Cost of operations (a):				
Eminent Domain Facilities.....	21	80	109	330
Closed Facilities.....	-	-	-	194
Total cost of operations.....	21	80	109	524
Depreciation expense (a):				
Eminent Domain Facilities.....	9	41	50	121
Closed Facilities.....	-	-	-	29
Total depreciation .....	9	41	50	150
Other items (b).....	2,370	5,180	2,370	6,323
Net discontinued operations (c)...	\$ 2,341	\$ 5,340	\$ 2,404	\$ 6,536

- (a) These amounts represent the historical operations of the Eminent Domain Facilities and the Closed Facilities, and include amounts previously classified as rental income, cost of operations, and depreciation expense in the financial statements in prior periods.
- (b) For the three and nine months ended September 30, 2006 and 2005, we recorded gains totaling \$2,370,000 and \$5,180,000, respectively, in connection with the Eminent Domain Facilities (see Note 5). Also during the nine months ended September 30, 2005, non-real estate assets of the Closed Facilities were sold, resulting in a gain on sale of approximately \$1,143,000.
- (c) Earnings per share were increased by \$0.02 and \$0.04 per share for the three and nine months ended September 30, 2006, respectively, (\$0.02 and \$0.05 per share for the three and nine months ended September 30, 2005), due to the impact from discontinued operations.

18

PUBLIC STORAGE, INC.  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
September 30, 2006  
(Unaudited)

5. Real Estate Facilities

Activity in real estate facilities is as follows:

Nine Months Ended  
September 30, 2006

-----  
(Amounts in

Edgar Filing: PUBLIC STORAGE INC /CA - Form 10-Q

	thousands)
Real estate facilities, at cost:	
Balance at December 31, 2005.....	\$ 5,930,484
Facilities consolidated pursuant to EITF 04-5 (Note 2)	22,459
Merger with Shurgard (Note 3).....	4,979,859
Newly developed facilities opened for operations....	70,049
Acquisition of real estate facilities.....	103,544
Disposition of real estate facilities.....	(3,505)
Acquisition of minority interests.....	49,284
Capital improvements.....	44,366
Impact of foreign exchange rate changes.....	(20,849)
	-----
Balance at September 30, 2006.....	11,175,691
	-----
Accumulated depreciation:	
Balance at December 31, 2005.....	(1,500,128)
Additions during the year.....	(156,395)
Dispositions during the year.....	786
	-----
Balance at September 30, 2006.....	(1,655,737)
	-----
Construction in process:	
Balance at December 31, 2005.....	54,472
Current development.....	70,903
Merger with Shurgard (Note 3).....	90,669
Expensing of development costs.....	(9,319)
Dispositions.....	(4,970)
Newly developed facilities opened for operations....	(70,049)
Impact of foreign exchange rate changes.....	(643)
	-----
Balance at September 30, 2006.....	131,063
	-----
Total real estate facilities at September 30, 2006.....	\$ 9,651,017
	=====

During the nine months ended September 30, 2006, we opened three newly developed self-storage facilities (281,000 net rentable square feet) for an aggregate cost of \$49,519,000. We also completed three projects which converted space previously used by our containerized storage business into 92,000 net rentable square feet of self-storage space for an aggregate cost of \$7,243,000. In addition, we completed five expansion projects to existing self-storage facilities adding 116,000 net rentable square feet for an aggregate cost of \$9,556,000, and we incurred trailing development costs with respect to development projects completed in prior years, for an aggregate net cost of \$3,731,000.

During the nine months ended September 30, 2006, we received \$466,000 of additional proceeds from a partial condemnation that occurred in 2005. These additional proceeds are reflected as a gain on disposition of real estate on our condensed consolidated statements of income for the three and nine months ended September 30, 2006. During the nine months ended September 30, 2006, we disposed of parcels of vacant land for an aggregate of \$6,558,000, recording a gain of \$756,000. Also during the nine months ended September 30, 2006, we received the proceeds, totaling \$4,257,000, from the condemnation of one of our self-storage facilities located in Seattle Washington, and recorded a gain of \$2,370,000.



## Edgar Filing: PUBLIC STORAGE INC /CA - Form 10-Q

(Unaudited)

Excluding self-storage facilities acquired in the merger with Shurgard (see Note 3), during the nine months ended September 30, 2006, we acquired 12 self-storage facilities (872,000 net rentable square feet) from third parties at an aggregate cost of \$103,544,000, consisting of \$98,954,000 in cash and assumed mortgage debt totaling \$4,590,000.

Construction in process at September 30, 2006 consists primarily of 44 projects (2,322,000 net rentable square feet) which expand or enhance the visual and structural appeal of our existing self-storage facilities with costs incurred of \$71,707,000 at September 30, 2006 and total estimated costs to complete of \$147,525,000, and five projects (428,000 net rentable square feet) to convert space at former containerized storage facilities into self-storage space with costs incurred of \$4,872,000 at September 30, 2006 and total estimated costs to complete of \$14,011,000. Also in connection with the merger with Shurgard, we acquired a pipeline of future developments in existing Shurgard markets in Europe, which at September 30, 2006 was comprised of 11 facilities (541,000 net rentable square feet) with costs incurred of approximately \$54,484,000 and total estimated costs to complete of approximately \$34,983,000.

Our policy is to capitalize interest incurred on debt during the course of construction of our self-storage facilities. Interest capitalized for the three and nine months ended September 30, 2006 was \$530,000 and \$1,599,000, respectively. Interest capitalized for the three and nine months ended September 30, 2005 was \$710,000 and \$2,054,000, respectively.

### 6. Investment in Real Estate Entities

-----

At September 30, 2006, our investments in real estate entities consist of ownership interests in the Unconsolidated Entities. These interests are non-controlling interests of less than 50% and are accounted for using the equity method of accounting. Accordingly, earnings are recognized based upon our ownership interest in each of the entities. The accounting policies of these entities are similar to those of the Company.

For the three and nine months ended September 30, 2006, we recognized earnings from our investments in real estate entities of \$2,618,000 and \$9,208,000, respectively, as compared to \$9,853,000 and \$20,382,000 for the same periods in 2005.

Equity in earnings of real estate entities includes our pro rata share of the net impact of gains/losses on sales of assets and impairment charges relating to the impending sale of real estate assets as well as our pro rata share of the impact of the application of EITF Topic D-42 on redemptions of preferred securities recorded by PSB. Our net pro rata share from these items resulted in a net decrease of equity in earnings of \$576,000 and \$282,000 for the three and nine months ended September 30, 2006, respectively. For the three and nine months ended September 30, 2005, our pro rata share of these items resulted in net increases of \$5,458,000 and \$7,033,000, respectively. See the condensed financial information with respect to PSB below for further information regarding these items recorded by PSB.

We received cash distributions from our investments in real estate entities for the nine months ended September 30, 2006 and 2005, of \$15,049,000 and \$17,015,000, respectively.

The following table sets forth our investments in real estate entities at September 30, 2006 and December 31, 2005, and our equity in earnings of real estate entities for the three and nine months ended September 30, 2006 and 2005

Edgar Filing: PUBLIC STORAGE INC /CA - Form 10-Q

(amounts in thousands):

20

PUBLIC STORAGE, INC.  
 NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
 September 30, 2006  
 (Unaudited)

	Investments in Real Estate Entities at		Equity in Earnings of Real Estate Entities for the Three Months Ended September 30,	
	September 30, 2006	December 31, 2005	2006	2005
PSB (a).....	\$ 285,260	\$ 288,694	\$ 2,018	\$ 8,251
Acquisition Joint Venture....	2,018	2,865	38	7
Other Investments (b).....	14,590	36,996	562	1,595
Total.....	\$ 301,868	\$ 328,555	\$ 2,618	\$ 9,853

(a) Equity in earnings of real estate entities includes our pro rata share of the net impact of gains/losses on sale of assets and impairment charges relating to the impending sale of real estate assets as well as our pro rata share of the impact of the application of EITF Topic D-42 on redemptions of preferred securities recorded by PSB. Our net pro rata share from these items resulted in a net decrease of equity in earnings of \$576,000 and \$282,000 for the three and months ended September 30, 2006, respectively. For the three and nine months ended September 30, 2005, our pro rata share of these items resulted in net increases of \$5,458,000 and \$7,033,000, respectively.

(b) As described in Note 2, effective January 1, 2006 we commenced consolidating the accounts of three limited partnerships previously accounted for under the equity method of accounting. As a result, we decreased our investment in these partnerships by approximately \$20,846,000 on January 1, 2006.

Investment in PSB  
 -----

PS Business Parks, Inc. is a REIT traded on the American Stock Exchange, which controls an operating partnership (collectively, the REIT and the operating partnership are referred to as "PSB"). We have a 44% common equity interest in PSB as of September 30, 2006. This common equity interest is comprised of our ownership of 5,418,273 shares of PSB's common stock and 7,305,355 limited partnership units in the operating partnership at both September 30, 2006 and December 31, 2005; these limited partnership units are convertible at our option, subject to certain conditions, on a one-for-one basis into PSB common stock. Based upon the closing price at September 30, 2006 (\$60.30 per share of PSB common stock), the shares and units had a market value of approximately \$767.2 million as compared to a book value of \$285.3 million.

## Edgar Filing: PUBLIC STORAGE INC /CA - Form 10-Q

At September 30, 2006, PSB owned approximately 18.2 million net rentable square feet of commercial space. In addition, PSB manages commercial space owned by the Company and the Consolidated Entities pursuant to property management agreements.

The following table sets forth the condensed statements of operations for the nine months ended September 30, 2006 and 2005 (as restated for discontinued operations), and the condensed balance sheets of PSB at September 30, 2006 and December 31, 2005. The amounts below represent 100% of PSB's balances and not our pro rata share.

	Nine Months Ended September 30,	
	2006	2005
	(Amounts in thousands)	
Total revenue.....	\$ 180,050	\$ 164,240
Cost of operations and other operating expenses..	(60,618)	(52,938)
Other income and expense, net.....	3,799	1,914
Depreciation and amortization.....	(63,720)	(56,203)
Discontinued operations (a).....	1,643	14,549
Minority interest.....	(13,450)	(12,445)
	\$ 47,704	\$ 59,117

21

PUBLIC STORAGE, INC.  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
September 30, 2006  
(Unaudited)

	September 30, 2006	December 31, 2005
	(Amounts in thousands)	
Total assets (primarily real estate).....	\$ 1,442,588	\$ 1,463,678
Total debt.....	43,267	25,893
Other liabilities.....	45,357	39,126
Preferred equity and preferred minority interest.	705,250	729,100
Common equity and common minority interest.....	648,714	669,559

(a) Included in discontinued operations for the nine months ended September 30, 2006 is a net gain on disposition of real estate of \$2,328,000 (\$16,529,000 for the same period in 2005).

Acquisition Joint Venture  
-----

As described more fully under "Accounting for Acquisition Joint Venture" in Note 2, we formed a partnership (the "Acquisition Joint Venture") in

Edgar Filing: PUBLIC STORAGE INC /CA - Form 10-Q

January 2004. Through December 31, 2004, the Acquisition Joint Venture had acquired two self-storage facilities directly from third parties at an aggregate cost of \$9,086,000, of which our pro rata share was \$2,930,000. Our investment in these two facilities is accounted for using the equity method of accounting. In December 2004, we sold seven facilities to the Acquisition Joint Venture as well as interest in three facilities in the first quarter of 2005. Our accounting for these ten facilities is described in Note 2.

The following table sets forth certain condensed financial information (representing 100% of this entity's balances and not our pro rata share) with respect to the two self-storage facilities acquired by the Acquisition Joint Venture that we account for using the equity method of accounting:

	Nine Months Ended September 30,	
	2006	2005
	(Amounts in thousands)	
Total revenue.....	\$ 1,104	\$ 96
Cost of operations and other expenses.....	(407)	(36)
Depreciation and amortization.....	(207)	(20)
Net income.....	\$ 490	\$ 39

	September 30, 2006	December 2005
	(Amounts in thousands)	
Total assets (primarily storage facilities).....	\$ 8,350	\$ 8,97
Liabilities.....	82	6
Partners' equity.....	8,268	8,91

Other Investments

Other Investments at September 30, 2006 consist primarily of our aggregate 23% ownership interest in four limited partnerships (collectively, the "Other Investments") owning an aggregate of 20 storage facilities. The following table sets forth certain condensed financial information (representing 100% of these entities' balances and not our pro rata share) with respect to Other Investments:

Edgar Filing: PUBLIC STORAGE INC /CA - Form 10-Q

	Nine Months Ended September 30,	
	2006	2005
	(Amounts in thousands)	
Total revenue.....	\$ 11,989	\$ 11,356
Cost of operations and other expenses.....	(4,512)	(4,344)
Depreciation and amortization.....	(1,305)	(1,331)
Net income.....	\$ 6,172	\$ 5,681

	September 30,	December
	2006	200
	(Amounts in thousands)	
Total assets (primarily storage facilities).....	\$ 40,298	\$ 39,813
Other liabilities.....	1,280	1,178
Partners' equity.....	39,018	38,635

7. Revolving Line of Credit

We have a revolving line of credit (the "Credit Agreement") with an aggregate limit with respect to borrowings and letters of credit of \$200,000,000, that has a maturity date of April 1, 2007 and bears an annual interest rate ranging from the London Interbank Offered Rate ("LIBOR") plus 0.50% to LIBOR plus 1.20% depending on our credit ratings (currently LIBOR plus 0.50%). In addition, we are required to pay a quarterly commitment fee ranging from 0.15% per annum to 0.30% per annum depending on our credit ratings (currently the fee is 0.15% per annum).

The Credit Agreement includes various covenants, the more significant of which require us to (i) maintain a balance sheet leverage ratio of less than 0.55 to 1.00, (ii) maintain certain quarterly interest and fixed-charge coverage ratios (as defined therein) of not less than 2.25 to 1.0 and 1.5 to 1.0, respectively, and (iii) maintain a minimum total shareholders' equity (as defined therein). In addition, we are limited in our ability to incur additional borrowings (we are required to maintain unencumbered assets with an aggregate book value equal to or greater than 1.5 times our unsecured recourse debt). We were in compliance with all covenants of the Credit Agreement at September 30, 2006. At September 30, 2006 and November 8, 2006, we had no outstanding borrowings on our line of credit.

At September 30, 2006 and November 8, 2006, excluding Shurgard, we had undrawn standby letters of credit totaling \$17,919,000. The beneficiaries of these standby letters of credit were certain insurance companies associated with our captive insurance and tenant re-insurance activities. At September 30, 2006 and November 8, 2006, we had undrawn standby letters of credit totaling \$3,149,000 assumed in the merger with Shurgard. The beneficiaries of these standby letters of credit were certain insurance companies associated with Shurgard's workers' compensation program and as collateral for certain construction projects and a mortgage note.

Edgar Filing: PUBLIC STORAGE INC /CA - Form 10-Q

8. Notes Payable  
-----

The carrying amounts of our notes payable at September 30, 2006 and December 31, 2005 consist of the following:

23

PUBLIC STORAGE, INC.  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
September 30, 2006  
(Unaudited)

	September 30, 2006
	----- (Amount in millions)
<b>DOMESTIC NOTES PAYABLE:</b>	
5.875% effective and stated note rate, principal due in March 2013 (a).....	\$ 200,0
5.73% effective rate, 7.75% stated note rate, principal due in February 2011 (carrying amount includes \$15,004 of unamortized premium at September 30, 2006) (a).....	215,0
6.53% effective rate, 7.625% stated note rate, note principal due in April 2007 (carrying amount includes \$304 of unamortized premium at September 30, 2006) (a).....	50,3
7.66% senior unsecured note due January 2007.....	11,2
<b>DOMESTIC MORTGAGE NOTES:</b>	
Fixed rate mortgage notes payable, secured by 64 real estate facilities with a net book value of \$802,100 at September 30, 2006, average effective interest rates of 5.59% and stated note rates between 4.95% and 8.78%, due between December 2006 and August 2015 (carrying amount includes \$4,683 of unamortized premium at September 30, 2006) (b).....	169,7
Variable rate mortgage notes payable, secured by seven real estate facilities with a net book value of \$57,300 at September 30, 2006, (average interest rate of 7.29% at September 30, 2006), due between December 2007 and August 2010 (b).....	12,3
Fixed rate mortgage notes payable, secured by 35 real estate facilities with a net book value of \$204,200 at September 30, 2006, stated note rates between 5.05% and 8.75%, principal and interest payable monthly, due at varying dates between October 2009 and September 2028 (carrying amount includes \$4,708 of unamortized premium at September 30, 2006) (c).....	92,8
<b>EUROPEAN NOTES PAYABLE ASSUMED FROM SHURGARD:</b>	
EUR 325 notes payable due in 2011, collateralized by 101 real estate facilities with a net book value of \$784,871 at September 30, 2006 (interest rate of EURIBOR + 0.51%, 3.578% average for quarter ended September 30, 2006,	

Edgar Filing: PUBLIC STORAGE INC /CA - Form 10-Q

3.928% rate at September 30, 2006).....	412,2
First and Second Shurgard credit agreement, due in 2008 and 2009, secured by 53 real estate facilities with a net book value of \$363,970 at September 30, 2006 (interest rate of EURIBOR + 2.25%, 5.345% average for quarter ended September 30, 2006, 5.455% rate at September 30, 2006).....	256,5
Liability under Capital Leases.....	6,3
	-----
Total notes payable.....	\$ 1,426,5
	=====

- (a) We assumed the 5.875%, 7.75%, and 7.625% notes payable in connection with the merger with Shurgard. The notes were recorded at their estimated fair value based upon the estimated market rate upon assumption of approximately 5.875%, 5.73%, and 6.53%, respectively, an aggregate of approximately \$465,692,000 as compared to the actual assumed balances of an aggregate \$450,000,000. This initial premium of \$15,692,000 is amortized over the remaining term of the notes using the effective interest method.

24

PUBLIC STORAGE, INC.  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
September 30, 2006  
(Unaudited)

- (b) We assumed additional domestic mortgage notes in connection with the merger with Shurgard. The mortgage notes were recorded at their estimated fair value based upon the estimated market rate upon assumption of approximately 5.71%, an aggregate of approximately \$184,592,000 as compared to the actual assumed balances of an aggregate \$179,827,000. This initial premium of \$4,765,000 is amortized over the remaining term of the mortgage notes using the effective interest method.
- (c) We assumed a 5.58% mortgage note in connection with a property acquisition during the first quarter of 2006. This note was recorded at the stated rate, which we believe approximates the market rate for similar mortgage notes.

The domestic notes payable require interest and principal payments to be paid semi-annually and have various restrictive covenants, all of which have been met at September 30, 2006. Balances at September 30, 2006 include \$476,508,000 in domestic notes payable acquired in the merger with Shurgard, which includes \$15,308,000 of unamortized premium.

The domestic mortgage notes require interest and principal payments to be paid monthly and have various restrictive covenants, all of which have been met at September 30, 2006.

We assumed a 5.58% mortgage note in connection with a property acquisition during the first quarter of 2006. The note was recorded at the stated rate, which we believe approximates the market rate for similar mortgage notes.

We also assumed an additional \$671,047,000 in debt in the merger with Shurgard, comprised of Shurgard's line of credit totaling \$603,772,000, and certain variable rate notes totaling \$67,275,000. This debt was repaid immediately following the merger.

## Edgar Filing: PUBLIC STORAGE INC /CA - Form 10-Q

Balances at September 30, 2006 include \$182,083,000 in domestic mortgage notes payable acquired in the merger with Shurgard, which includes \$4,683,000 of unamortized premium.

First Shurgard and Second Shurgard have senior credit agreements denominated in euros to borrow, in aggregate, up to EUR 271.1 million (\$343.9 million as of September 30, 2006). As of September 30, 2006, the available amount under those credit facilities was, in aggregate, EUR 68.9 million (\$87.4 million). Our draws under the First Shurgard and Second Shurgard credit facilities are determined on a development project basis, or on an acquisition project basis when applicable for Second Shurgard, and can be limited if the completion of projects is not timely and if we have certain cost overruns. The credit facilities also require us to maintain a maximum loan to value of the collateral ratio and a minimum debt service ratio. As of September 30, 2006, we were in compliance with these financial covenants.

At September 30, 2006, approximate principal maturities of our notes payable are as follows (amounts in thousands):

	Domestic Notes Payable	Domestic Mortgage Notes Payable	European Notes Payable	Capit -
	-----	-----	-----	-----
2006 (remainder of).....	\$ 135	\$ 6,470	\$ 1,522	
2007.....	64,391	11,587	7,421	
2008.....	3,201	27,852	153,685	
2009.....	3,390	9,371	93,873	
2010.....	3,590	17,753	-	
Thereafter.....	401,801	201,858	412,280	
	-----	-----	-----	
	\$ 476,508	\$ 274,891	\$ 668,781	
	=====	=====	=====	
Weighted average rate.....	5.9%	5.6%	4.4%	
	=====	=====	=====	

25

PUBLIC STORAGE, INC.  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
September 30, 2006  
(Unaudited)

We incurred interest expense with respect to our notes payable aggregating \$12,075,000 and \$5,800,000 for the nine months ended September 30, 2006 and 2005, respectively. These amounts were comprised of \$13,043,000 and \$6,574,000 in cash for the nine months ended September 30, 2006 and 2005, respectively, less \$968,000 and \$774,000 in amortization of premium, respectively.

9. Debt to Joint Venture Partner  
-----

As described more fully in Note 2, our partner's equity contributions with respect to certain transactions has been classified as debt under the caption "Debt to Joint Venture Partner." The balances of \$37,214,000 and \$35,697,000 as of September 30, 2006 and December 31, 2005, approximate the fair



## Edgar Filing: PUBLIC STORAGE INC /CA - Form 10-Q

value of our partners' interest in these facilities as of each respective date. We increased the note balance by \$1,386,000 at September 30, 2006 as a result of our periodic review of fair value as described in Note 2.

A total of \$2,276,000 and \$2,182,000 was recorded as interest expense on our condensed consolidated statements of income with respect to our Debt to Joint Venture Partner during the nine months ended September 30, 2006 and 2005, respectively, representing our partner's pro rata share of net earnings with respect to the properties we sold to the Acquisition Joint Venture (an 8.5% return on their investment). This interest expense was comprised of a total of \$2,146,000 and \$2,052,000 paid to our joint venture partner (an 8.0% return payable currently in accordance with the partnership agreement) during the nine months ended September 30, 2006 and 2005, respectively, and increases in the Debt to Joint Venture Partner of \$130,000 for each of the nine month periods ended September 30, 2006 and 2005, respectively.

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

### 10. Derivative Financial Instruments

-----

As described in Note 2, under Derivative Financial Instruments, we report these derivative financial instruments at fair value on our unaudited condensed consolidated balance sheet at September 30, 2006 and changes in fair values from the date of the Shurgard merger through September 30, 2006, have been recognized in earnings. The respective balances of these financial instruments are included in other assets and accrued and other liabilities as follows:

	September 30, 2006
	-----
	(Amounts in thousands)
<b>Assets:</b>	
Debt-related contracts.....	\$ 3,553
Foreign currency exchange contracts.....	1,243
	-----
	\$ 4,796
	=====
<b>Liabilities:</b>	
Debt-related contracts.....	\$ (5,097)
Foreign currency exchange contracts.....	(4,721)
	-----
	\$ (9,818)
	=====

### 11. Minority Interest

-----

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

## Edgar Filing: PUBLIC STORAGE INC /CA - Form 10-Q

September 30, 2006

(Unaudited)

### Preferred Partnership Interests

The following table summarizes the preferred partnership units outstanding at September 30, 2006 and December 31, 2005:

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

Income allocated to the preferred minority interests totaled \$13,652,000 and \$13,430,000 for the nine months ended September 30, 2006 and 2005, respectively, comprised of distributions paid and the allocation of income resulting from the application of EITF Topic D-42 (see below).

On March 17, 2005, we redeemed all outstanding 9.5% Series N Preferred Units (\$40,000,000) and on March 29, 2005 we redeemed all outstanding 9.125% Series O Preferred Units (\$45,000,000), for their face value plus accrued distributions, for cash. The redemption of these Preferred Units resulted in an increase in income allocated to minority interests and a reduction to the Company's net income for the three months ended March 31, 2005 of \$874,000 as a result of the application of the SEC's clarification of EITF Topic D-42 which allocates the excess of the stated amount of the preferred units over their carrying amount to the holders of the redeemed securities.

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

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

### Other Partnership Interests

-----

Income is allocated to the minority interests based upon their pro rata interest in the operating results of the Consolidated Entities. The following tables set forth the minority interests at September 30, 2006 and December 31, 2005 as well as the income allocated to minority interests for the three and nine months ended September 30, 2006 and 2005 with respect to the other

Edgar Filing: PUBLIC STORAGE INC /CA - Form 10-Q

partnership interests (amounts in thousands):

27

PUBLIC STORAGE, INC.  
 NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
 September 30, 2006  
 (Unaudited)

Description	Minority Interest at	
	September 30, 2006	December 31, 2005
Convertible Partnership Units.....	\$ 6,031	\$ 6,177
Newly Consolidated Partnerships.....	4,372	-
Shurgard domestic joint ventures.....	8,912	-
Shurgard European joint ventures.....	131,983	-
Other consolidated partnerships.....	23,406	22,793
Total other partnership interests.....	\$ 174,704	\$ 28,970

Description	Minority Interests in Income (Loss) for the Three Months Ended		Minority Int for the September 3 2006
	September 30, 2006	September 30, 2005	
Convertible Partnership Units.....	\$ 120	\$ 148	\$ 3
Consolidated Development Joint Venture..	-	826	
Newly Consolidated Partnerships.....	1,468	-	3,6
Shurgard domestic joint ventures.....	192	-	1
Shurgard European joint ventures.....	(1,279)	-	(1,2
Other consolidated partnerships.....	2,686	2,678	7,9
Total other partnership interests.....	\$ 3,187	\$ 3,652	\$ 10,8

Distributions paid to minority interests for the three months ended September 30, 2006 and 2005 were \$3,570,000 and \$2,607,000, respectively and for the nine months ended September 30, 2006 and 2005 were \$11,037,000 and \$11,805,000, respectively.

Convertible Partnership Units

As of September 30, 2006, one of the Consolidated Entities had approximately 231,978 convertible operating partnership units ("Convertible Units") outstanding (237,934 at December 31, 2005) representing a limited partnership interest in the partnership. The Convertible Units are convertible on a one-for-one basis (subject to certain limitations) into our common stock at the option of the unit-holder. Minority interest in income with respect to the Convertible Units reflects the Convertible Units' share of our net income, with net income allocated to minority interests with respect to weighted average

## Edgar Filing: PUBLIC STORAGE INC /CA - Form 10-Q

outstanding Convertible Units on a per unit basis equal to diluted earnings per common share. During the three months ended September 30, 2006, a total of 5,956 units were converted into common shares (none during 2005). As a result of this conversion, minority interest was reduced by \$155,000.

### Consolidated Development Joint Venture

-----

In November 1999, we formed a development joint venture (the "Consolidated Development Joint Venture") with a joint venture partner (PSAC Storage Investors, LLC, referred to as "PSAC") whose partners included a third party institutional investor and B. Wayne Hughes ("Mr. Hughes"), the Chairman of the Board of the Company, to develop approximately \$100,000,000 of self-storage facilities and to purchase \$100,000,000 of the our Equity Stock, Series AAA (see Note 12). We owned a controlling interest in the Consolidated Development Joint Venture and included the accounts of this partnership in our consolidated financial statements since its inception. PSAC's interest in the Consolidated Development Joint Venture was accounted for as minority interest, as denoted in the above table.

28

PUBLIC STORAGE, INC.  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
September 30, 2006  
(Unaudited)

On August 5, 2005, we acquired the institutional investor's interest in PSAC for approximately \$41,420,000 in cash and on November 17, 2005, we acquired the remaining interest in PSAC from Mr. Hughes for \$64,513,000 in cash.

### Newly Consolidated Partnerships

-----

As further described in Note 2, effective January 1, 2006 we commenced consolidating the accounts of three partnerships that we had previously accounted for under the equity method of accounting. This consolidation resulted in a \$3,963,000 increase in minority interest on January 1, 2006. Effective January 1, 2006, the income allocated to the interests we do not own in these three partnerships is shown in the table above under Newly Consolidated Partnerships.

### Shurgard European Joint Ventures

-----

Through the merger with Shurgard, we acquired two joint venture entities: First Shurgard SPRI (First Shurgard) formed in January 2003 and Second Shurgard SPRL (Second Shurgard) formed in May 2004. Those joint ventures were expected to develop or acquire up to approximately 75 storage facilities in Europe. Shurgard Europe has a 20% interest in each of these ventures. We have determined that First Shurgard and Second Shurgard are each VIEs, and that we are the primary beneficiary. Accordingly, First Shurgard and Second Shurgard have been consolidated in our unaudited condensed consolidated financial statements. At September 30, 2006, First Shurgard and Second Shurgard had aggregate total assets of \$449.3 million, total liabilities of \$284.3 million, and credit facilities collateralized by assets with net book value of \$256.5 million. As of September 30, 2006, First Shurgard's and Second Shurgard's creditors had no recourse to the general credit of Public Storage or Shurgard Europe other than a commitment, previously made by Shurgard, to subscribe to up to \$20 million and an additional EUR 7.5 million (\$9.5 million as of September 30, 2006) in preferred bonds in order for First Shurgard to fulfill its obligations under its senior credit agreement. We have an option to put 80% of

## Edgar Filing: PUBLIC STORAGE INC /CA - Form 10-Q

the bonds issued by First Shurgard to Crescent Euro Self Storage Investments, Shurgard Europe's partner in the joint venture.

On September 5, 2006, we informed the joint venture partners of First Shurgard and Second Shurgard of our intention to purchase their interests in First Shurgard and Second Shurgard, pursuant to an "exit procedure" that we believe is provided for in the respective agreements. Our joint venture partners currently contest whether we have the right to purchase their interests under this procedure and, accordingly, it is uncertain as to whether we will acquire their interests pursuant to these provisions.

On August 24, 2006, we informed the joint venture partners of First Shurgard and Second Shurgard of our intention to purchase their interests in First Shurgard and Second Shurgard, pursuant to an "exit procedure" that we believe is provided for in the respective agreements. Our joint venture partners currently contest whether we have the right to purchase their interests under this procedure and, accordingly, it is uncertain as to whether we will acquire their interest pursuant to these provisions.

### Shurgard Domestic Joint Ventures

-----

Following the merger with Shurgard, we acquired the minority interests in certain of Shurgard's joint ventures, for an aggregate of approximately \$60,799,000 in cash. As a result of these transactions, we obtained the remaining interest in a total of 67 facilities. This acquisition was recorded as a reduction in minority interest totaling \$11,515,000, with the remainder allocated to real estate (\$49,284,000).

29

PUBLIC STORAGE, INC.  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
September 30, 2006  
(Unaudited)

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

### Other Consolidated Partnerships

-----

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

At September 30, 2006, the Other Consolidated Partnerships reflect common equity interests that we do not own in 22 entities owning an aggregate of 73 self-storage facilities.

In January 2005, we acquired a portion of the minority interest we did not own in one of the Consolidated Entities for an aggregate of \$4,366,000 in cash. The acquisition resulted in the reduction of minority interest by \$2,828,000 with the excess of cost over underlying book value (\$1,538,000) allocated to real estate.

## Edgar Filing: PUBLIC STORAGE INC /CA - Form 10-Q

In April 2005, we acquired minority interests we did not own in two Consolidated Entities for an aggregate of \$32,432,000 in cash. The acquisition resulted in a reduction of minority interest of \$15,394,000 with the excess of cost over underlying book value (\$17,038,000) allocated to real estate.

In August 2005, we acquired the remaining minority interests we did not own in the Consolidated Entities for an aggregate of \$14,597,000 in cash. The acquisition resulted in a reduction of minority interest of \$7,151,000 with the excess of cost over underlying book value (\$7,446,000) allocated to real estate.

### Impact of SFAS No. 150

-----

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

30

PUBLIC STORAGE, INC.  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
September 30, 2006  
(Unaudited)

### 12. Shareholders' Equity

-----

#### Cumulative Preferred Stock

-----

At September 30, 2006 and December 31, 2005, we had the following series of Cumulative Preferred Stock outstanding:

Series	Earliest Redemption Date (a)	Dividend Rate	At September 30, 2006		At De
			Shares Outstanding	Carrying Amount	Shares Outstandi
(Dollar amounts in thousand)					
Series R	9/28/06	8.000%	-	\$ -	20,400
Series S	10/31/06	7.875%	-	-	5,750
Series T	1/18/07	7.625%	6,086	152,150	6,086
Series U	2/19/07	7.625%	6,000	150,000	6,000
Series V	9/30/07	7.500%	6,900	172,500	6,900
Series W	10/6/08	6.500%	5,300	132,500	5,300
Series X	11/13/08	6.450%	4,800	120,000	4,800
Series Y	1/2/09	6.850%	1,600,000	40,000	1,600,000
Series Z	3/5/09	6.250%	4,500	112,500	4,500

Edgar Filing: PUBLIC STORAGE INC /CA - Form 10-Q

Series A	3/31/09	6.125%	4,600	115,000	4,600
Series B	6/30/09	7.125%	4,350	108,750	4,350
Series C	9/13/09	6.600%	4,600	115,000	4,600
Series D	2/28/10	6.180%	5,400	135,000	5,400
Series E	4/27/10	6.750%	5,650	141,250	5,650
Series F	8/23/10	6.450%	10,000	250,000	10,000
Series G	12/12/10	7.000%	4,000	100,000	4,000
Series H	1/19/11	6.950%	4,200	105,000	-
Series I	5/3/11	7.250%	20,700	517,500	-
Series K	8/8/11	7.250%	18,400	460,000	-
Total Cumulative Preferred Stock			1,715,486	\$ 2,927,150	1,698,336

- (a) Except under certain conditions relating to the Company's qualification as a REIT, the Cumulative Preferred Stock are not redeemable prior to the dates indicated. On or after the dates indicated, each series of Cumulative Preferred Stock will be redeemable, at our option, in whole or in part, at \$25.00 per depositary share (or per share in the case of the Series Y), plus accrued and unpaid dividends.

The holders of our Cumulative Preferred Stock have general preference rights with respect to liquidation and quarterly distributions. Holders of the preferred stock, except under certain conditions and as noted below, will not be entitled to vote on most matters. In the event of a cumulative arrearage equal to six quarterly dividends or failure to maintain a Debt Ratio (as defined) of 50% or less, holders of all outstanding series of preferred stock (voting as a single class without regard to series) will have the right to elect two additional members to serve on the Company's Board of Directors until events of default have been cured. At September 30, 2006, there were no dividends in arrears and the Debt Ratio was 12.8%.

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

31

PUBLIC STORAGE, INC.  
 NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
 September 30, 2006  
 (Unaudited)

On January 19, 2006, we issued 4,000,000 depositary shares, with each depositary share representing 1/1,000 of a share of our 6.95% Cumulative Preferred Stock, Series H. The offering resulted in \$100,000,000 of gross proceeds. On January 27, 2006, we issued an additional 200,000 depositary shares, with each depositary share representing 1/1,000 of a share of our 6.95% Cumulative Preferred Stock, Series H resulting in \$5,000,000 of gross proceeds. On May 3, 2006, we issued 20,700,000 depositary shares, with each depositary share representing 1/1,000 of a share of our 7.25% Cumulative Preferred Stock, Series I. The offering resulted in approximately \$517,500,000 of gross proceeds.

During the first quarter of 2006, we redeemed our 8.60% Series Q Cumulative Preferred Stock for \$172,500,000 plus accrued and unpaid dividends. The Series Q Cumulative Preferred Stock was called for redemption in December 2005; accordingly, the redemption value of \$172,500,000 was classified as a liability at December 31, 2005.

## Edgar Filing: PUBLIC STORAGE INC /CA - Form 10-Q

During 2005, we issued four series of Cumulative Preferred Stock: Series D - issued February 28, 2005, net proceeds totaling \$130,548,000, Series E - issued April 27, 2005, net proceeds totaling \$136,601,000, Series F - issued August 23, 2005, net proceeds totaling \$242,550,000 and Series G - issued December 12, 2005, aggregate net proceeds totaling \$96,886,000.

During the third quarter of 2006, we issued 18,400,000 depositary shares each representing 1/1,000 of a share our 7.25% Cumulative Preferred Stock, Series K, for gross proceeds of approximately \$460 million (including the underwriters' overallotment option, which was exercised).

On September 26, 2006, we called for redemption all outstanding depositary shares representing interests in our 7.875% Cumulative Preferred Stock Series S. The redemption occurred on October 31, 2006. The aggregate redemption amount paid to all holders of the depositary shares, before payment of accrued dividends, was approximately \$143,750,000. The redemption value of \$143,750,000 is classified as a liability at September 30, 2006 on our unaudited condensed consolidated balance sheet.

On September 28, 2006, we redeemed all of our outstanding 8.00% Series R Cumulative Preferred Stock for \$510,000,000 plus accrued and unpaid dividends.

Subsequent to September 30, 2006, we issued 9,200,000 depositary shares each representing 1/1,000 of a share our 6.75% Cumulative Preferred Stock, Series L, for gross proceeds of approximately \$230,000,000.

### Equity Stock

-----

The Company is authorized to issue 200,000,000 shares of Equity Stock. The Articles of Incorporation provide that the Equity Stock may be issued from time to time in one or more series and gives the Board of Directors broad authority to fix the dividend and distribution rights, conversion and voting rights, redemption provisions and liquidation rights of each series of Equity Stock.

### Equity Stock, Series A

-----

At September 30, 2006 and December 31, 2005, we had 8,744,193 depositary shares outstanding, each representing 1/1,000 of a share of Equity Stock, Series A ("Equity Stock A"). The Equity Stock A ranks on parity with common stock and junior to the Cumulative Preferred Stock with respect to general preference rights and has a liquidation amount which cannot exceed \$24.50 per share. Distributions with respect to each depositary share shall be the lesser of: (i) five times the per share dividend on our common stock or (ii) \$2.45 per annum. We have no obligation to pay distributions on the depositary shares if no distributions are paid to common shareholders.

32

PUBLIC STORAGE, INC.  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
September 30, 2006  
(Unaudited)

Except in order to preserve the Company's Federal income tax status as a REIT, we may not redeem the depositary shares before March 31, 2010. On or after March 31, 2010, we may, at our option, redeem the depositary shares at \$24.50 per depositary share. If the Company fails to preserve its Federal income



## Edgar Filing: PUBLIC STORAGE INC /CA - Form 10-Q

tax status as a REIT, the depositary shares will be convertible at the option of the shareholder into .956 shares of common stock. The depositary shares are otherwise not convertible into common stock. Holders of depositary shares vote as a single class with holders of our common stock on shareholder matters, but the depositary shares have the equivalent of one-tenth of a vote per depositary share.

### Equity Stock, Series AAA

-----

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

### Common Stock

-----

During the nine months ended September 30, 2006, we issued 168,575 shares of our Common Stock in connection with employee stock-based compensation. On August 22, 2006, we issued 38,913,187 shares of our Common Stock in connection with our merger with Shurgard (see Note 3). Subsequent to the acquisition, we also issued 1,808,962 shares of our Common Stock to former employees of Shurgard in connection with employee stock-based compensation arrangements that existed at the time of the acquisition.

At September 30, 2006 and December 31, 2005, certain entities we consolidate owned 1,146,207 shares of our Common Stock. These shares continue to be legally issued and outstanding. In the consolidation process, these shares and the related balance sheet amounts have been eliminated. In addition, these shares are not included in the computation of weighted average shares outstanding.

The following chart reconciles our legally issued and outstanding shares of Common Stock and the reported outstanding shares of Common Stock at September 30, 2006 and December 31, 2005:

	September 30, 2006	December 31, 2005
Reconciliation of Common Shares Outstanding		
Legally issued and outstanding shares.....	170,132,450	129,235,770
Less - Shares owned by entities we consolidate that are eliminated in consolidation....	(1,146,207)	(1,146,207)
Reported issued and outstanding shares.....	168,986,243	128,089,563
	=====	=====

### Dividends

-----

The following table summarizes dividends declared and paid during the nine months ended September 30, 2006:

Edgar Filing: PUBLIC STORAGE INC /CA - Form 10-Q

PUBLIC STORAGE, INC.  
 NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
 September 30, 2006  
 (Unaudited)

	Distributions Per Share or Depositary Share	Total Distributions
	-----	-----
Preferred Stock:		
-----		
Series Q.....	\$0.108	\$ 742,000
Series R.....	\$1.483	30,255,000
Series S.....	\$1.477	8,490,000
Series T.....	\$1.430	8,700,000
Series U.....	\$1.430	8,580,000
Series V.....	\$1.406	9,703,000
Series W.....	\$1.219	6,459,000
Series X.....	\$1.209	5,805,000
Series Y.....	\$1.284	2,055,000
Series Z.....	\$1.172	5,274,000
Series A.....	\$1.148	5,283,000
Series B.....	\$1.336	5,811,000
Series C.....	\$1.238	5,694,000
Series D.....	\$1.159	6,258,000
Series E.....	\$1.266	7,152,000
Series F.....	\$1.209	12,093,000
Series G.....	\$1.313	5,250,000
Series H.....	\$1.219	5,121,000
Series I.....	\$0.750	15,529,000
Series K.....	\$0.272	5,002,000
		-----
		159,256,000
Common Stock:		
Equity Stock, Series A.....	\$1.838	16,068,000
Common .....	\$1.500	213,281,000
		-----
Total dividends.....		\$ 388,605,000
		=====

The dividend rate on the common stock was \$0.50 per common share and \$1.50 per common share for the three and nine months ended September 30, 2006, respectively. The dividend rate on the Equity Stock A was \$0.6125 per depositary share and \$1.8375 per depositary share for the three and nine months ended September 30, 2006, respectively.

13. Segment Information

Description of Each Reportable Segment

Our reportable segments reflect significant operating activities that are evaluated separately by management. We have five reportable segments: self-storage - Domestic operations, self-storage - Foreign operations, containerized storage operations, commercial property operations, and ancillary

## Edgar Filing: PUBLIC STORAGE INC /CA - Form 10-Q

operations. These segments are organized generally based upon their operating characteristics.

34

PUBLIC STORAGE, INC.  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
September 30, 2006  
(Unaudited)

The self-storage - Domestic segment comprises the direct ownership, development, and operation of traditional storage facilities in the U.S., and the ownership of equity interests in entities that own storage properties in the U.S. The self-storage - European segment comprises the direct ownership, development, and operation of storage facilities in Europe. The containerized storage operations represent another segment. The commercial property segment reflects our interest in the ownership, operation, and management of commercial properties. The vast majority of the commercial property operations are conducted through PSB, and to a much lesser extent the Company and certain of its unconsolidated subsidiaries own commercial space, managed by PSB, within facilities that combine storage and commercial space for rent. The ancillary operations include four sources of operating income: (i) the reinsurance of policies against losses to goods stored by tenants in our self-storage facilities, (ii) sale of merchandise at our self-storage facilities, (iii) truck rentals at our self-storage facilities and (iv) management of facilities owned by third-party owners and facilities owned by the Unconsolidated Entities.

#### Measurement of Segment Profit or Loss

-----

We evaluate performance and allocate resources based upon the net segment income of each segment. Net segment income represents net income in conformity with GAAP and our significant accounting policies as denoted in Note 2, before interest and other income, interest expense, corporate general and administrative expense, and minority interest in income. The accounting policies of the reportable segments are the same as those described in the Summary of Significant Accounting Policies.

Interest and other income, interest expense, corporate general and administrative expense, minority interest in income and gains and losses on sales of real estate assets are not allocated to segments because management does not utilize them to evaluate the results of operations of each segment.

#### Measurement of Segment Assets

-----

No segment data relative to assets or liabilities is presented, because we do not consider the historical cost of our real estate facilities and investments in real estate entities in evaluating the performance of operating management or in evaluating alternative courses of action. The only other types of assets that might be allocated to individual segments are trade receivables, payables, and other assets that arise in the ordinary course of business, but they are also not a significant factor in the measurement of segment performance.

#### Presentation of Segment Information

-----

The following table reconciles the revenues of each segment to our total revenues (thousands):

Edgar Filing: PUBLIC STORAGE INC /CA - Form 10-Q

RECONCILIATION OF REVENUES BY SEGMENT

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2006	2005	2006	2005
Self-Storage - Domestic.....	\$ 311,493	\$ 243,702	\$ 825,403	\$ 648,100
Self-Storage - European.....	17,348	-	17,348	17,348
Commercial properties.....	3,408	2,918	9,413	9,413
Containerized storage facilities	4,353	4,480	12,483	12,483
Ancillary operations.....	22,106	17,587	55,649	55,649
Interest and other income not allocated to segment.....	12,651	4,717	27,773	27,773
<b>Total Revenues.....</b>	<b>\$ 371,359</b>	<b>\$ 273,404</b>	<b>\$ 948,069</b>	<b>\$ 791,766</b>

35

PUBLIC STORAGE, INC.  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
September 30, 2006  
(Unaudited)

The following table reconciles the performance of each segment, in terms of segment income, to our consolidated net income.

	Three Months Ended September 30,	
	2006	2005
(Amounts in thousands)		
Reconciliation of Net Income by Segment:		
Self-storage - Domestic		
Self-storage net operating income before depreciation		
and amortization .....	\$ 210,801	\$ 163,429
Depreciation and amortization.....	(97,689)	(47,021)
Equity in earnings - self-storage property operations....	621	1,649
Discontinued operations (Note 4) .....	2,341	5,340
<b>Total self-storage - Domestic segment net income.....</b>	<b>116,074</b>	<b>123,397</b>
Self-storage - European		
Self-storage net operating income before depreciation		
and amortization .....	8,824	-
Depreciation and amortization.....	(15,020)	-
<b>Total self-storage - European segment net income.....</b>	<b>(6,196)</b>	<b>-</b>
Commercial properties		

Edgar Filing: PUBLIC STORAGE INC /CA - Form 10-Q

Commercial properties net operating income before depreciation and amortization.....	1,911	1,796	
Depreciation and amortization.....	(643)	(562)	
Equity in earnings - commercial property operations.....	8,885	9,385	
	-----	-----	
Total commercial property segment net income.....	10,153	10,619	
	-----	-----	
Containerized storage			
Containerized storage net operating income before depreciation.....	446	804	
Containerized storage depreciation.....	(179)	(313)	
Discontinued operations (Note 4) .....	-	-	
	-----	-----	
Total containerized storage segment net income.....	267	491	
	-----	-----	
Ancillary Operations			
Revenue less cost of operations.....	8,659	5,974	
	-----	-----	
Other items not allocated to segments			
General and administrative and other included in equity in earnings.....	(6,888)	(1,181)	
Cumulative effect of change in accounting principal.....	-	-	
Interest and other income.....	12,651	4,717	
General and administrative.....	(36,242)	(5,621)	
Interest expense.....	(9,323)	(2,471)	
Casualty loss.....	-	(196)	
Gain (loss) on disposition of real estate assets.....	756	(142)	
Foreign currency exchange loss.....	(172)	-	
Income from derivatives, net.....	32	-	
Minority interest in income.....	(8,590)	(7,243)	
	-----	-----	
Total other items not allocated to segments	(47,776)	(12,137)	
	-----	-----	
Total consolidated net income.....	\$ 81,181	\$ 128,344	\$
	=====	=====	=====

14. Stock-Based Compensation

Stock Options

We have a 1990 Stock Option Plan (the "1990 Plan"), which provides for the grant of non-qualified stock options. We have a 1994 Stock Option Plan (the "1994 Plan"), a 1996 Stock Option and Incentive Plan (the "1996 Plan"), a 2000

PUBLIC STORAGE, INC.  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
September 30, 2006  
(Unaudited)

Non-Executive/Non-Director Stock Option and Incentive Plan (the "2000 Plan"), a 2001 Non-Executive/Non-Director Stock Option and Incentive Plan (the "2001 Non-Executive Plan") and a 2001 Stock Option and Incentive Plan (the "2001 Plan"), each of which provides for the grant of non-qualified options and incentive stock options. (The 1990 Plan, the 1994 Plan, the 1996 Plan and the 2000 Plan are collectively referred to as the "PSI Plans"). Under the PSI Plans,

## Edgar Filing: PUBLIC STORAGE INC /CA - Form 10-Q

the Company has granted non-qualified options to certain directors, officers and key employees to purchase shares of the Company's common stock at a price equal to the fair market value of the common stock at the date of grant. Generally, options under the PSI Plans vest over a three-year period from the date of grant at the rate of one-third per year (options granted after, December 31, 2002 vest generally over a five-year period) and expire (i) under the 1990 Plan, five years after the date they became exercisable and (ii) under the 1994 Plan, the 1996 Plan and the 2000 Plan, ten years after the date of grant. The 1996 Plan, the 2000 Plan, the 2001 Non-Executive Plan and the 2001 Plan also provide for the grant of restricted stock (see below) to officers, key employees and service providers on terms determined by an authorized committee of the Board of Directors.

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

For the three and nine months ended September 30, 2006 we recorded \$360,000 and \$958,000, respectively, in stock option compensation expense related to options granted after January 1, 2002, as compared to \$240,000 and \$667,000, respectively, for the same periods in 2005.

A total of 157,500 stock options were granted during the nine months ended September 30, 2006, 128,273 shares were exercised, and 2,000 shares were forfeited. On August 22, 2006, in connection with our merger with Shurgard, we converted each outstanding Shurgard stock option into 0.82 options exercisable for shares of the Company's Common Stock. This conversion resulted in the issuance of 1,912,828 stock options. As of September 30, 2006, 1,746,900 of the 1,912,828 stock options issued in this exchange were exercised. A total of 1,616,301 stock options were outstanding at September 30, 2006 (1,423,146 at December 31, 2005).

### Restricted Stock Units

-----

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

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

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

Outstanding restricted stock units are included on a one-for-one basis

## Edgar Filing: PUBLIC STORAGE INC /CA - Form 10-Q

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

37

PUBLIC STORAGE, INC.  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
September 30, 2006  
(Unaudited)

During the nine months ended September 30, 2006, 387,420 restricted stock units were granted, 20,960 restricted stock units were forfeited, and 60,700 restricted stock units vested. This vesting resulted in the issuance of 40,302 shares of the Company's Common Stock. In addition, cash compensation was paid to employees in lieu of 20,398 shares of Common Stock based upon the market value of the stock at the date of vesting, and used to settle the employees' tax liability generated by the vesting.

At September 30, 2006, approximately 605,590 restricted stock units were outstanding (299,830 at December 31, 2005). A total of \$1,481,000 and \$3,910,000 in restricted stock expense was recorded for the three and nine months ended September 30, 2006, respectively (\$956,000 and \$2,912,000, respectively, for the same periods in 2005).

15. Related Party Transactions

Relationships and transactions with the Hughes Family

Mr. Hughes and his family (the "Hughes Family") have ownership interests in, and operate approximately 44 self-storage facilities in Canada under the name "Public Storage" ("PS Canada") pursuant to a license agreement with the Company. We currently do not own any interests in these facilities nor do we own any facilities in Canada. The Hughes Family owns approximately 27% of our Common Stock outstanding at September 30, 2006. We have a right of first refusal to acquire the stock or assets of the corporation that manages the 44 self-storage facilities in Canada, if the Hughes Family or the corporation agrees to sell them. However, we have no interest in the operations of this corporation, we have no right to acquire this stock or assets unless the Hughes Family decides to sell, the right of first refusal does not apply to the self-storage facilities, and we receive no benefit from the profits and increases in value of the Canadian self-storage facilities.

Through PSIC and PSCI-H, we continue to reinsure risks relating to loss of goods stored by tenants in the self-storage facilities in Canada. We acquired the tenant insurance business on December 31, 2001 through its acquisition of PSIC. During each of the nine months ended September 30, 2006 and 2005, we received \$759,000 and \$795,000, respectively, in reinsurance premiums attributable to the Canadian Facilities. Since our right to provide tenant reinsurance to the Canadian Facilities may be qualified, there is no assurance that these premiums will continue.

In November 1999, we formed the Consolidated Development Joint Venture with a joint venture partner whose partners include an institutional investor and Mr. Hughes. On August 5, 2005, we acquired the institutional investor's interest in PSAC for approximately \$41,420,000 in cash. This acquisition gave us a controlling position in PSAC and the right to acquire the remaining interest in PSAC held by Mr. Hughes, which we exercised, for a stipulated amount of

## Edgar Filing: PUBLIC STORAGE INC /CA - Form 10-Q

\$64,513,000 plus accrued preferred return on November 17, 2005.

The Company and Mr. Hughes are co-general partners in certain of the Consolidated Entities and the Unconsolidated Entities. Mr. Hughes and his family also own limited partnership interests in certain of these partnerships. The Company and Mr. Hughes and his family receive distributions from these partnerships in accordance with the terms of the partnership agreements.

### Other Related Party Transactions

-----

Ronald L. Havner, Jr. is our vice-chairman and chief executive officer, and he is chairman of the board of PSB.

Dann V. Angeloff, a director of the Company, is the general partner of a limited partnership formed in June 1973 that owns a self-storage facility that is managed by us. We recorded management fees with respect to this facility

38

PUBLIC STORAGE, INC.  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
September 30, 2006  
(Unaudited)

amounting to \$18,000 and \$49,000 for the three and nine months ended September 30, 2006, respectively, compared to \$11,000 and \$33,000 for the three and nine months ended, September 30, 2005, respectively.

PSB manages certain of the commercial facilities that we own pursuant to management agreements for a management fee equal to 5% of revenues. We paid a total of \$147,000, and \$442,000 for the three and nine months ended September 30 2006, respectively, and \$145,000 and \$434,000, respectively, for the same periods in 2005 in management fees with respect to PSB's property management services. At September 30, 2006, we have recorded amounts owed to PSB of \$282,000 (\$551,000 at December 31, 2005), for management fees and certain other operating expenses related to the managed facilities, paid by PSB on our behalf. These amounts are the result of a time lag between PSB paying such expenditures and being reimbursed by us.

We manage the Company's wholly-owned self-storage facilities as well as the facilities owned by the Unconsolidated Entities and the Consolidated Entities on a joint basis, in order to take advantage of scale and other efficiencies. As a result, significant components of self-storage operating costs, such as payroll costs, advertising and promotion, data processing, and insurance expenses are shared and allocated among the various entities using methodologies meant to fairly allocate such costs based upon the related activities. The total of such expenses which were included in the operations of the Unconsolidated Entities were approximately \$503,000, and \$1,770,000 for the three and nine months ended September 30, 2006, respectively, compared to \$974,000 and \$3,193,000 for the three and nine months ended September 30, 2005, respectively.

Pursuant to a cost-sharing and administrative services agreement, PSB reimburses us for certain administrative services. PSB's share of these costs totaled approximately \$80,000 and \$240,000 for the three and nine months ended September 30, 2006, respectively, and \$85,000 and \$255,000, respectively, for the same periods in 2005.

Stor-RE and third party insurance carriers have provided PS Canada, the Company, PSB, and other affiliates of the Company with liability and casualty



## Edgar Filing: PUBLIC STORAGE INC /CA - Form 10-Q

insurance coverage until March 31, 2004. PS Canada has a 2.2% interest, and PSB has a 4.0% interest, in Stor-RE. PS Canada and PSB obtained their own liability and casualty insurance covering occurrences after April 1, 2004. For occurrences before April 1, 2004, STOR-Re continues to provide liability and casualty insurance coverage consistent with the relevant agreements.

### 16. Commitments and Contingencies

-----

#### LEGAL MATTERS

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

The plaintiff in this case filed a suit against the Company on behalf of a putative class of renters who rented self-storage units from the Company. Plaintiff alleges that the Company misrepresented the size of its storage units, has brought claims under California statutory and common law relating to consumer protection, fraud, unfair competition, and negligent misrepresentation, and is seeking monetary damages, restitution, and declaratory and injunctive relief.

The claim in this case is substantially similar to those in Henriquez v. Public Storage, Inc., which was disclosed in prior reports. In January 2003, the plaintiff caused the Henriquez action to be dismissed.

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

39

PUBLIC STORAGE, INC.  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
September 30, 2006  
(Unaudited)

Drake v. Shurgard Storage Centers, Inc. (filed September 2002) (Superior Court  
-----  
of California - Orange County)  
-----

This is a companion case to the Serrao matter discussed above. The plaintiff alleges the same set of operative facts and seeks the same relief as in Serrao against Shurgard Storage Centers, Inc. ("Shurgard"), whose liability Public Storage assumed following the merger of Public Storage and Shurgard on August 22, 2006. There is currently pending a motion for class certification, which has yet to be ruled on. We cannot presently determine the potential total damages, if any, or the ultimate outcome of the litigation. We vigorously contested the motion for class certification and will vigorously defend this action.

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

## Edgar Filing: PUBLIC STORAGE INC /CA - Form 10-Q

Court - Central District of California)  
-----

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

At the end of December 2004, the same shareholder referred to above and a second shareholder filed this shareholder's derivative complaint naming as defendants the Company's directors (and two former directors) and certain officers of the Company. The matters alleged in this complaint relate to PSIC, the Hughes Family's Canadian self-storage operations and the Company's 1995 reorganization. In July 2006, the Court granted the defendants' motion to dismiss the amended Complaint without leave to amend. In August 2006, Plaintiffs filed a notice of appeal of the Court's decision. We believe the litigation will not have any financially adverse effect on the Company (other than the costs and other expenses relating to the lawsuit).

Brinkley v. Public Storage, Inc. (filed April, 2005) (Superior Court of  
-----  
California - Los Angeles County)  
-----

The plaintiff sued the Company on behalf of a purported class of California non-exempt employees based on various California wage and hour laws and seeking monetary damages and injunctive relief. In May 2006, a motion for class certification was filed seeking to certify five subclasses. Plaintiff sought certification for alleged meal period violations, rest period violations, failure to pay for travel time, failure to pay for mileage reimbursement, and for wage statement violations. In October 2006, the Court declined to certify three out of the five subclasses. The Court did, however, certify subclasses based on alleged meal period and wage statement violations. The maximum potential liability cannot presently be estimated. We intend to vigorously contest the substantive merits of the two remaining subclasses that were certified.

Simas v. Public Storage, Inc. (filed January, 2006) (Superior Court of  
-----  
California - Orange County)  
-----

The plaintiff brings this action against the Company on behalf of a purported class who bought insurance coverage at Company's facilities alleging that the Company does not have a license to offer, sell and/or transact storage insurance. The action was brought under California Business and Professions Code Section 17200 and seeks retention, monetary damages and injunctive relief. The Company filed a demurrer to the complaint. While the demurrer was pending, Plaintiff amended the complaint to allege a national class and claims for unfair business practices, unjust enrichment, money had and received, and negligent and intentional misrepresentation. We renewed our demurrer and moved to strike the national class allegations. The Court dismissed all the claims with leave to amend, except for the claim for unjust enrichment. Based on this ruling, the Court held that the motion to strike was moot. Plaintiff elected not to amend her complaint and is therefore only proceeding with the claim for unjust enrichment. We are vigorously contesting the claims upon which this lawsuit is based, including any efforts for class certification.

PUBLIC STORAGE, INC.  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
September 30, 2006  
(Unaudited)

Other Items

-----

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

INSURANCE AND LOSS EXPOSURE

Our facilities have historically carried insurance, including fire, earthquake, flood, and general liability coverage through STOR-Re and PSIC-H, our captive insurance programs, and insure portions of these risks through nationally recognized insurance carriers. Our captive insurance programs also insure affiliates of the Company.

The Company, STOR-Re, PSIC-H and its affiliates' maximum aggregate annual exposure for losses that are below the deductibles set forth in the third-party insurance contracts, assuming multiple significant events occur, is approximately \$35,000,000. In addition, if losses exhaust the third-party insurers' limit of coverage of \$125,000,000 for property coverage (a maximum of \$80,000,000 with respect to earthquake coverage) and \$102,000,000 for general liability, our exposure could be greater. These limits are higher than estimates of maximum probable losses that could occur from individual catastrophic events (i.e. earthquake and wind damage) determined in engineering and actuarial studies.

Our tenant re-insurance program, operating through PSIC through March 31, 2004, and through PSIC-H beginning April 1, 2004, reinsures policies against claims for losses to goods stored by tenants at our self-storage facilities. For 2005, we had outside third-party insurance coverage for claims paid exceeding \$500,000 resulting from any individual event, to a limit of \$10,000,000. Effective January 1, 2006, such coverage was revised to cover claims paid exceeding \$1,500,000 resulting from any individual event, to a limit of \$9,000,000. At September 30, 2006, we had approximately 368,000 reinsured policies outstanding representing aggregate coverage of approximately \$877 million.

DEVELOPMENT AND ACQUISITION OF REAL ESTATE FACILITIES

We currently have 60 projects in our development pipeline, including expansions and enhancements to existing self-storage facilities. The total estimated cost of these facilities is approximately \$327,582,000, of which \$131,063,000 has been spent at September 30, 2006. These projects are subject to contingencies. See Note 5 for further discussion of our development projects as of September 30, 2006.

Subsequent to September 30, 2006, we did not acquire and are not currently under contract to acquire any additional self-storage facilities from third parties.

## Edgar Filing: PUBLIC STORAGE INC /CA - Form 10-Q

### 17. Subsequent Events

-----  
On October 17, 2006, we issued 9,200,000 depository shares each representing 1/1,000 of a share our 6.75% Cumulative Preferred Stock, Series L, for gross proceeds of approximately \$230 million (including the underwriters' overallotment option, which was exercised).

41

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

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

Forward Looking Statements: All statements in this document, other than statements of historical fact, are forward-looking statements which may be identified by the use of the words "expects," "believes," "anticipates," "should," "estimates" and similar expressions. These forward-looking statements involve known and unknown risks and uncertainties, which may cause Public Storage's actual results and performance to be materially different from those expressed or implied in the forward-looking statements. Factors and risks that may impact future results and performance are described in Item 1A, "Risk Factors" in Part II of this Quarterly Report on Form 10Q. These risks include, but are not limited to, the following: risks related to the merger with Shurgard including difficulties that may be encountered in integrating Public Storage and Shurgard, loss of personnel as a result of the merger, and the impact of the merger on occupancy and rental rates, the inability to realize or delays in realizing expected results from the merger, unanticipated operating costs resulting from the merger, and risks associated with international operations; changes in general economic conditions and in the markets in which Public Storage operates; the impact of competition from new and existing storage and commercial facilities and other storage alternatives, which could impact rents and occupancy levels at our facilities; difficulties in Public Storage's ability to evaluate, finance and integrate acquired and developed properties into its existing operations and to fill up those properties, which could adversely affect our profitability; the impact of the regulatory environment as well as national, state, and local laws and regulations including, without limitation, those governing Real Estate Investment Trusts, which could increase our expenses and reduce cash available for distribution; consumers' failure to accept the containerized storage concept; difficulties in raising capital at reasonable rates, which would impede our ability to grow; delays in the development process; economic uncertainty due to the impact of war or terrorism. We disclaim any obligation to update publicly or otherwise revise any forward-looking statements, whether as a result of new information, new estimates, or other factors, events or circumstances after the date of this document, except where expressly required by law.

#### CRITICAL ACCOUNTING POLICIES

Management's Discussion and Analysis of Financial Condition and Results of Operations discusses our consolidated financial statements, which have been prepared in accordance with generally accepted accounting principles in the United States ("GAAP"). The preparation of our financial statements and related disclosures in conformity with GAAP and our discussion and analysis of our financial condition and results of operations requires management to make judgments, assumptions and estimates that affect the amounts reported in our

## Edgar Filing: PUBLIC STORAGE INC /CA - Form 10-Q

condensed consolidated financial statements and accompanying notes. Note 2 to our condensed consolidated financial statements summarizes the significant accounting policies and methods used in the preparation of our condensed consolidated financial statements and related disclosures.

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

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

We therefore do not estimate or accrue any federal income tax expense. This estimate could be incorrect, because due to the complex nature of the REIT qualification requirements, the ongoing importance of factual determinations and the possibility of future changes in our circumstances, we cannot be assured that we actually have satisfied or will satisfy the requirements for taxation as a REIT for any particular taxable year. For any taxable year that we fail or have failed to qualify as a REIT and applicable relief provisions did not apply,

42

we would be taxed at the regular corporate rates on all of our taxable income, whether or not we made or make any distributions to our shareholders. Any resulting requirement to pay corporate income tax, including any applicable penalties or interest, could have a material adverse impact on our financial condition or results of operations. Unless entitled to relief under specific statutory provisions, we also would be disqualified from taxation as a REIT for the four taxable years following the year during which qualification was lost. There can be no assurance that we would be entitled to any statutory relief.

**IMPAIRMENT OF LONG-LIVED ASSETS:** Substantially all of our assets consist of long-lived assets, including real estate and goodwill. We evaluate our goodwill for impairment on an annual basis, and on a quarterly basis evaluate other long-lived assets for impairment. As described in Note 2 to our condensed consolidated financial statements, the evaluation of goodwill for impairment entails valuation of the reporting unit to which goodwill is allocated, which involves significant judgment in the area of projecting earnings, determining appropriate price-earnings multiples, and discount rates. In addition, the evaluation of other long-lived assets for impairment requires determining whether indicators of impairment exist, which is a subjective process. When any indicators of impairment are found, the evaluation of such long-lived assets then entails projections of future operating cash flows, which also involves significant judgment. Future events, or facts and circumstances that currently exist, that we have not yet identified, could cause us to conclude in the future that other long-lived assets are impaired. Any resulting impairment loss could have a material adverse impact on our financial condition and results of operations.

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

## Edgar Filing: PUBLIC STORAGE INC /CA - Form 10-Q

financial condition or results of operations.

**ESTIMATED LEVEL OF RETAINED RISK AND UNPAID TENANT CLAIM LIABILITIES:** As described in Notes 2 and 16 to our condensed consolidated financial statements, we retain certain risks with respect to property perils, legal liability, and other such risks. In addition, a wholly-owned subsidiary of the Company reinsures policies against claims for losses to goods stored by tenants in our self-storage facilities. In connection with these risks, we accrue losses based upon the estimated level of losses incurred using certain actuarial assumptions followed in the insurance industry and based on recommendations from an independent actuary that is a member of the American Academy of Actuaries. While we believe that the amounts of the accrued losses are adequate, the ultimate liability may be in excess of or less than the amounts recorded. At September 30, 2006, we had approximately 368,000 reinsured policies outstanding representing aggregate coverage of approximately \$877 million.

**ACCRUALS FOR CONTINGENCIES:** We are exposed to business and legal liability risks with respect to events that have occurred, but in accordance with accounting principles generally accepted in the United States, we have not accrued for such potential liabilities because the loss is either not probable or not estimable or because we are not aware of the event. Future events and the result of pending litigation could result in such potential losses becoming probable and estimable, which could have a material adverse impact on our financial condition or results of operations. Some of these potential losses, of which we are aware, are described in Note 16 to our condensed consolidated financial statements.

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

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

43

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

## Edgar Filing: PUBLIC STORAGE INC /CA - Form 10-Q

### MERGER WITH SHURGARD

As previously announced, on March 6, 2006, the boards of directors of Public Storage and Shurgard approved a definitive merger agreement under which Public Storage merged with Shurgard. The merger was approved by the shareholders of both companies and was completed on August 22, 2006. Under the terms of the merger agreement, Public Storage issued, in a taxable transaction, approximately 39 million shares of common stock to holders of Shurgard's common stock and assumed Shurgard's debt of approximately \$2.0 billion. On the day of the merger, we repaid Shurgard's line of credit and certain variable rate notes, totaling approximately \$671 million, with the remaining \$1.3 billion in Shurgard debt remaining outstanding. In addition, approximately \$138 million of Shurgard's preferred stock was redeemed on the day of the merger. Shortly following the merger, we incurred an additional \$49.4 million in cash costs primarily for attorneys, bankers, and severance payments to Shurgard employees.

In addition, pursuant to the merger we issued a total of 1.9 million stock options to former holders of Shurgard stock options. Approximately 1.7 million of these stock options were exercised through September 30, 2006, resulting in aggregate exercise proceeds totaling approximately \$74.4 million.

Included in general and administrative expense for the three and nine months ended September 30, 2006, respectively, are costs related to the merger, as well as expenditures in planning and completing the integration of the two companies of approximately \$18.1 million and \$20.5 million, respectively.

In the fourth quarter, we expect to incur an additional \$15 million to \$20 million of additional costs related to the integration of the two companies, as well as costs associated with winding down Shurgard's business affairs.

### RESULTS OF OPERATIONS

-----  
FOR THE THREE MONTHS ENDED SEPTEMBER 30, 2006:

Net income for the three months ended September 30, 2006 was \$81,181,000 compared to \$128,344,000 for the same period in 2005, representing a decrease of \$47,163,000, or 36.7%. This decrease is primarily due to significant increases in depreciation and amortization expense, general and administrative expense and interest expense. Depreciation and amortization increased by approximately \$65.6 million due primarily to the addition of real estate facilities and intangible assets acquired in the merger with Shurgard Storage

44

Centers, Inc. ("Shurgard") and the corresponding depreciation and amortization related to such assets. General and administrative expense increased by approximately \$30.6 million principally as a result of integration expenses related to the Shurgard merger, development costs that were expensed with respect to terminated projects and contract termination fees; these costs in aggregate totaled \$29.6 million. In connection with the merger, we assumed \$1.3 billion in debt, and, as a result, interest expense increased by approximately \$6.9 million.

The negative impacts to our net income from the above mentioned items were partially offset by improved operations from our Same Store group of facilities, continued growth in operations from our newly developed and recently expanded facilities, continued growth in our recently acquired self-storage facilities including the facilities acquired in the merger with Shurgard, as well as higher interest income.

## Edgar Filing: PUBLIC STORAGE INC /CA - Form 10-Q

Our Same Store net operating income, before depreciation expense, increased by approximately \$9,256,000, or 6.6%, as a result of a 6.1% improvement in revenues partially offset by a 5.0% increase in cost of operations. Aggregate net operating income for our newly developed and recently expanded and acquired facilities (other than the Shurgard facilities) increased by approximately \$8,815,000. This increase was largely due to the impact of facilities acquired in 2005 and 2006, combined with continued fill-up of our newly developed and expansion facilities. For those facilities that were acquired in the merger, net operating income was approximately \$35,363,000, reflecting the results from the date of the merger, August 22, 2006, through September 30, 2006. Interest income increased as a result of earning higher interest rates on invested cash balances combined with significantly higher average cash balances invested in interest-bearing accounts as compared to the same period in 2005. Higher invested cash balances were primarily due to gross proceeds received from the issuance of Preferred Stock and Preferred Partnership Units in the second and third quarters of 2006. Substantially all of this cash was subsequently used to fund the cash requirements with respect to the Shurgard merger.

We had a net loss allocable to our common shareholders (after allocating net income to our preferred and equity shareholders) of \$6,083,000 or \$0.04 per common share on a diluted basis for the three months ended September 30, 2006 compared to income allocable to common shareholders of \$79,262,000 or \$0.62 per common share on a diluted basis for the same period in 2005, representing a decrease of \$85,345,000 or \$0.66 per diluted common share. The decreases in net income allocable to common shareholders on an aggregate and per-share basis are due primarily to the impact of the factors described above, combined with an increase in income allocated to preferred shareholders, as described below.

For the three months ended September 30, 2006 and 2005, we allocated \$60,265,000 and \$43,726,000 of our net income, respectively, to our preferred shareholders based on distributions paid. The year-over-year increase is due to the issuance of additional preferred securities, partially offset by the redemption of preferred securities that had higher dividend rates than the newly issued preferred securities. We also recorded allocations of income to our preferred shareholders with respect to the application of EITF Topic D-42, and recorded our equity share of such charges, totaling \$21,643,000 (or \$0.15 per diluted common share) for the three months ended September 30, 2006 in connection with the redemption of preferred securities.

Weighted average diluted shares increased to 145,387,000 for the three months ended September 30, 2006 from 128,742,000 for the three months ended September 30, 2005. The increase in weighted average diluted shares is due primarily to the issuance of approximately 38.9 million shares in the merger with Shurgard, which are included in our weighted average shares from August 22, 2006 through September 30, 2006.

FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2006:

Net income for the nine months ended September 30, 2006 was \$324,259,000 compared to \$333,021,000 for the same period in 2005, representing a decrease of \$8,762,000, or 2.6%. This decrease is primarily reflective of the third-quarter impacts described above with respect to depreciation and amortization, general and administrative expense and interest expense. These items were partially offset by improved operations from our Same Store, newly developed and acquired self-storage facilities (including the facilities acquired from Shurgard), reduced minority interest in income and higher interest income.



## Edgar Filing: PUBLIC STORAGE INC /CA - Form 10-Q

Same Store net operating income, before depreciation expense, increased by \$23,903,000, or 5.9%, as a result of a 5.6% improvement in revenues partially offset by a 5.1% increase in cost of operations. Aggregate net operating income for our newly developed, acquired and expansion self-storage facilities (excluding the Shurgard facilities) increased by approximately \$24,895,000 largely due to the impact of facilities acquired in 2005 and 2006, combined with continued fill-up of our newly developed and expansion facilities. We earned an aggregate of \$35,363,000 in net operating income in the third quarter with respect to the facilities acquired in the merger with Shurgard, reflecting their operating results from the date of the merger, August 22, 2006, through September 30, 2006. Minority interest in income declined due to the acquisition of minority interests that occurred in 2005. Interest income increased as a result of earning higher interest rates on invested cash balances, combined with higher average cash balances invested in interest-bearing accounts as compared to the same period in 2005.

Net income allocable to our common shareholders (after allocating net income to our preferred and equity shareholders) was \$127,292,000 or \$0.94 per common share on a diluted basis for the nine months ended September 30, 2006 compared to \$188,744,000 or \$1.46 per common share on a diluted basis for the same period in 2005, representing a decrease of \$0.52 per common share, or a decrease of 36%. The decreases in net income allocable to common shareholders and earnings per common diluted share are due primarily to the impact of the factors described above, in addition to increased income allocated to preferred shareholders, described below.

For the nine months ended September 30, 2006 and 2005, we allocated \$159,256,000 and \$126,286,000 of our net income, respectively, to our preferred shareholders based on distributions paid. The year-over-year increase is due to the issuance of additional preferred securities, partially offset by the redemption of preferred securities that had higher dividend rates than the newly issued preferred securities. We also recorded allocations of income to our preferred shareholders with respect to the application of EITF Topic D-42 totaling \$21,643,000 (or \$0.16 per diluted common share) and \$1,904,000 (or \$0.01 per diluted common share), for the nine months ended September 30, 2006 and 2005, respectively.

Weighted average diluted shares increased to 134,851,000 for the nine months ended September 30, 2006 from 128,844,000 for the nine months ended September 30, 2005. The increase in weighted average diluted shares is due primarily to the issuance of approximately 38.9 million shares in the merger with Shurgard, which are included in our weighted averages shares from August 22, 2006 through September 30, 2006.

In the ensuing discussions of our operations, we present "net operating income before depreciation and amortization and cost of operations before depreciation and amortization", which excludes the impact of depreciation expense. Although depreciation is an operating expense, we believe that these operating metrics are meaningful measures of operating performance, because we utilize these measures in making decisions with respect to capital allocations, in determining current property values, segment performance, and comparing period to period and market to market property operating results. Included in Note 13 to our September 30, 2006 condensed consolidated financial statements, "Segment Information," is a reconciliation of net operating income (before depreciation) by each respective operating segment to our consolidated net income.

### REAL ESTATE OPERATIONS

-----

SELF-STORAGE OPERATIONS: Our self-storage operations are by far the largest component of our operations, representing approximately 89% of our total

**Edgar Filing: PUBLIC STORAGE INC /CA - Form 10-Q**

revenues generated for the nine months ended September 30, 2006. The improvements in rental income for the periods presented on our condensed consolidated statements of income for the three and nine months ended September 30, 2006 are due to improvements in the performance of those facilities that we owned prior to January 1, 2004, and the addition of new facilities to our portfolio, either through our acquisition or development activities.

To enhance year-over-year comparisons, the following table summarizes, and the ensuing discussion describes, the self-storage operating results.

46

Self - storage operations summary:

	Three Months Ended September 30,			Nin
	2006	2005	Percentage Change	
(Dollar amounts in th				
Rental income (a):				
Same Store Facilities (b).....	\$ 221,386	\$ 208,745	6.1%	\$ 644,
Shurgard U.S. Facilities (c).....	38,941	-	-	38,
Shurgard European Facilities (d).....	17,348	-	-	17,
Acquired Facilities (e).....	17,454	10,674	63.5%	47,
Expansion Facilities (f).....	13,982	11,750	19.0%	39,
Developed Facilities (g).....	16,044	12,533	28.0%	43,
Newly consolidated facilities (h).....	3,686	-	-	10,
Total rental income.....	328,841	243,702	34.9%	842,
Cost of operations before depreciation and amortization (i):				
Same Store Facilities.....	71,115	67,730	5.0%	215,
Shurgard U.S. Facilities.....	12,402	-	-	12,
Shurgard European Facilities.....	8,524	-	-	8,
Acquired Facilities.....	6,605	4,200	57.3%	18,
Expansion Facilities.....	4,220	4,033	4.6%	12,
Developed Facilities.....	5,426	4,310	25.9%	15,
Newly consolidated facilities.....	924	-	-	2,
Total cost of operations.....	109,216	80,273	36.1%	286,
Net operating income before depreciation and amortization (j):				
Same Store Facilities.....	150,271	141,015	6.6%	428,
Shurgard U.S. Facilities.....	26,539	-	-	26,
Shurgard European Facilities.....	8,824	-	-	8,
Acquired Facilities.....	10,849	6,474	67.6%	29,
Expansion Facilities.....	9,762	7,717	26.5%	27,
Developed Facilities.....	10,618	8,223	29.1%	28,
Newly consolidated facilities.....	2,762	-	-	8,
Total net operating income before depreciation and amortization (j).....	219,625	163,429	34.4%	556,

Edgar Filing: PUBLIC STORAGE INC /CA - Form 10-Q

Depreciation and amortization expense:				
Same Store Facilities.....	(37,270)	(38,478)	(3.1)%	(112,
Shurgard U.S. Facilities.....	(48,032)	-	-	(48,
Shurgard European Facilities.....	(15,020)	-	-	(15,
Acquired Facilities.....	(4,649)	(2,508)	85.4%	(13,
Expansion Facilities.....	(3,765)	(2,739)	37.5%	(9,
Developed Facilities.....	(3,857)	(3,296)	17.0%	(10,
Newly consolidated facilities.....	(116)	-	-	(
	-----	-----	-----	-----
Total depreciation and amortization expense.	(112,709)	(47,021)	139.7%	(209,
	-----	-----	-----	-----
Net operating income:				
Same Store Facilities.....	113,001	102,537	10.2%	316,
Shurgard U.S. Facilities.....	(21,493)	-	-	(21,
Shurgard European Facilities.....	(6,196)	-	-	(6,
Acquired Facilities.....	6,200	3,966	56.3%	15,
Expansion Facilities.....	5,997	4,978	20.5%	17,
Developed Facilities.....	6,761	4,927	37.2%	17,
Newly consolidated facilities.....	2,646	-	-	7,
	-----	-----	-----	-----
Total net operating income.....	\$106,916	\$116,408	(8.2)%	\$346,
	=====	=====	=====	=====
Number of self-storage facilities (at end of				
period).....				2,
Net rentable square feet (in thousands, at end of				
period) (k): .....				132,

47

(a) Rental income includes late charges and administrative fees and is net of promotional discounts given. Rental income excludes retail sales, truck rental income and tenant reinsurance revenues generated at these facilities. Such ancillary revenues are reflected as a component of "Ancillary Operations" on our condensed consolidated statements of income.

(b) The Same Store Facilities include 1,266 facilities containing 73,946,000 net rentable square feet that have been owned prior to January 1, 2004 and operated at a mature, stabilized occupancy level since January 1, 2004.

(c) The Shurgard U.S. Facilities include 487 facilities containing 32,143,000 net rentable square feet that were acquired on August 22, 2006.

(d) The Shurgard European Facilities include 160 facilities containing 8,385,000 net rentable square feet that were acquired on August 22, 2006.

(e) The Acquired Facilities include 89 facilities containing 6,383,000 net rentable square feet that were acquired after January 1, 2004.

(f) The Expansion Facilities include 61 facilities containing 5,352,000 net rentable square feet of self-storage space; these facilities were owned since January 1, 2004, however, operating results are not comparable throughout the periods presented due primarily to expansions in their net rentable square feet (described below).

(g) The Developed Facilities include 61 facilities containing 5,102,000 net

## Edgar Filing: PUBLIC STORAGE INC /CA - Form 10-Q

rentable square feet of self-storage space. These facilities were developed and opened since January 1, 2002 at a total cost of \$538.9 million.

- (h) Effective January 1, 2006, in connection with our implementation of EITF 04-5, we commenced consolidation of the accounts of three limited partnerships that we had previously accounted for on the equity method of accounting. As a result, we began including the revenues and cost of operations of 16 facilities with an aggregate of 879,000 net rentable square feet in the table above.
- (i) Cost of operations includes all costs, both direct and indirect costs, incurred in the operating activities of the facilities. Cost of operations excludes, costs associated with retail sales, truck rentals, and tenant reinsurance activities; such costs are reflected under "Ancillary Operations" on our income statement.
- (j) Total net operating income before depreciation and amortization, which is a non-GAAP measure, for our self-storage segment is presented in Note 13 to our September 30, 2006 condensed consolidated financial statements, "Segment Information," which includes a reconciliation of net operating income before depreciation and amortization for this segment to our consolidated net income.
- (k) Square footage does not include 424,000 net rentable square feet of industrial space initially developed for pick-up and delivery activities. This space is being converted into self-storage space; see "Development Pipeline Summary" below.

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

### SELF-STORAGE OPERATIONS - SAME STORE FACILITIES

The Same Store Facilities contain approximately 73.9 million net rentable square feet, representing approximately 56% of the aggregate net rentable square feet of our consolidated self-storage portfolio. Revenues and operating expenses with respect to this group of properties are set forth in the above Self-Storage Operations table under the caption, "Same Store Facilities." These facilities are included in the Same Store Facilities because they are all stabilized and owned since January 1, 2004 and therefore provide meaningful comparative data for 2004, 2005 and 2006. The following table sets forth additional operating data with respect to the Same Store Facilities:

48

#### SAME STORE FACILITIES

Three Months Ended September 30,		Percentage
2006	2005	Change

(Dollar amounts in thousands, except for percentages)

Edgar Filing: PUBLIC STORAGE INC /CA - Form 10-Q

Rental income.....	\$ 211,252	\$ 199,139	6.1%
Late charges and administrative fees collected.....	10,134	9,606	5.5%
	-----	-----	-----
Total rental income.....	221,386	208,745	6.1%
	-----	-----	-----
Cost of operations before depreciation and amortization:			
Payroll expense.....	22,185	20,224	9.7%
Property taxes.....	20,376	19,573	4.1%
Repairs and maintenance.....	6,925	6,294	10.0%
Advertising and promotion.....	4,582	5,248	(12.7)%
Utilities.....	5,113	4,764	7.3%
Property insurance.....	2,860	1,932	48.0%
Telephone reservation center.....	2,055	2,239	(8.2)%
Other cost of management.....	7,019	7,456	(5.9)%
	-----	-----	-----
Total cost of operations.....	71,115	67,730	5.0%
	-----	-----	-----
Net operating income before depreciation and amortization (e).....	150,271	141,015	6.6%
Depreciation and amortization.....	(37,270)	(38,478)	(3.1)%
	-----	-----	-----
Net operating income.....	\$ 113,001	\$ 102,537	10.2%
	=====	=====	=====
Gross margin (before depreciation and amortization)	67.9%	67.6%	0.4%
Weighted average for the fiscal year:			
Square foot occupancy (a).....	91.4%	91.7%	(0.3)%
Realized annual rent per occupied square foot (b)	\$12.50	\$11.75	6.4%
REVPAF (c).....	\$11.43	\$10.77	6.1%
Weighted average at September 30:			
Square foot occupancy.....			
In place annual rent per occupied square foot (d)			
Total net rentable square feet (in thousands).....			

(a) Square foot occupancies represent weighted average occupancy levels over the entire period.

(b) Realized annual rent per occupied square foot is computed by dividing rental income, prior to late charges and administrative fees, by the weighted average occupied square footage for the period. Realized annual rent per occupied square foot takes into consideration promotional discounts, credit card fees and other costs that reduce rental income from the contractual amounts due.

(c) Annualized rental income per available square foot ("REVPAF") represents annualized rental income, prior to late charges and administrative fees, divided by total available net rentable square feet.

(d) In place annual rent per occupied square foot represents annualized contractual rents per occupied square foot without reductions for promotional discounts, and excludes late charges and administrative fees.

(e) Total net operating income before depreciation and amortization, which is a non-GAAP measure, for our same store facilities represents a portion of our total self-storage segment's net operating income before

## Edgar Filing: PUBLIC STORAGE INC /CA - Form 10-Q

depreciation and amortization, and is reconciled to the segment total in the table "self-storage operations summary" above. A reconciliation of our total self-storage segment's net operating income before depreciation and amortization to consolidated net income is included in Note 13 to our September 30, 2006 condensed consolidated financial statements, "Segment Information."

Rental income increased approximately 6.1% and 5.6% for the three and nine months ended September 30, 2006, respectively, as compared to the same periods in 2005. These increases were primarily attributable to higher average realized annual rental rates per occupied square foot, which were 6.4% and 5.6% higher for the three and nine months ended September 30, 2006, respectively, as compared to the same periods in 2005. Our occupancy levels remained approximately flat for each of the periods.

49

Our primary goal is to continue to grow rental income in a consistent and sustainable manner. Growth in rental income will depend upon various factors, including our ability to (i) maintain high occupancy levels, (ii) increase rental rates charged to both new and existing customers, and (iii) reduce the amount of promotional discounts to attract new tenants.

Demand for self-storage space in each market is affected by many factors which are beyond our control. Such factors include general economic conditions, moving activities, changes in demographic trends and population density, as well as the level of development of new self-storage facilities. We believe that our share of the overall storage demand in any particular market is impacted by our and our competitors' marketing, pricing, and promotional activities, as well as the quality of execution of our property personnel at the facilities.

We regularly evaluate the level of demand for our self-storage space by monitoring reservation activity, move-ins, move-outs, and the level of telephone and internet inquiries as a primary basis for our marketing, pricing, and promotional decisions, as well as to identify localized execution issues. There can be no assurance that we will achieve our goal of sustainable growth in our rental income, while sustaining our occupancy levels.

Due to the merger with Shurgard, we have acquired an additional 487 self-storage facilities in the United States, including 383 facilities we refer to below as the Shurgard domestic same-store facilities, and 104 additional facilities which are referred to as the Shurgard domestic non-same store facilities. These facilities have an aggregate occupancy of approximately 84.4% at September 30, 2006, as compared to 91.4% for the Public Storage Same-Store facilities. It is our objective to close this occupancy gap, by raising average occupancies of the acquired Shurgard properties to levels experienced by Public Storage's Same Stores. We believe, at least in the short term, this strategy will put pressure on occupancies and rental rate growth on the existing Same Store Facilities as demand may shift to the acquired Shurgard facilities as we adjust the level of discounts and monthly rents. In attempting to accomplish this objective, we have significantly expanded our domestic pricing, promotional, and media programs, and aggregate media costs will more than double in the fourth quarter versus the aggregate level of spending incurred in the fourth quarter of 2005. These costs will be allocated to all the facilities, including the same-store as well as the acquired Shurgard facilities.

Cost of operations (excluding depreciation and amortization) increased by 5.0% and 5.1% for the three and nine months ended September 30, 2006, respectively, as compared to the same periods in 2005.

## Edgar Filing: PUBLIC STORAGE INC /CA - Form 10-Q

Payroll expense has increased 9.7% and 5.9% for the three and nine months ended September 30, 2006, respectively, as compared to the same periods in 2005, due principally to higher wage rates required for some of our job classifications because of a tight labor market in several market areas, higher overtime hours required due to understaffing issues, and the absence of a workers compensation adjustment in the third quarter of 2005 which reflected improving trends. We expect this trend to continue in the fourth quarter of 2006.

Repairs and maintenance expenditures increased 10.0% and 7.2% during the three and nine months ended September 30, 2006. During the second quarter, we experienced higher repair and maintenance costs to address certain deferred maintenance issues localized to a few markets. We expect this trend to continue in the fourth quarter of 2006.

Advertising and promotion costs decreased 12.7% and 0.3% for the three and nine months ended September 30, 2006, respectively, compared to the same periods in 2005. The decreases in advertising and promotion costs for the three and nine months ended September 30, 2006 are due principally to decreases in internet and television advertising expenses. Television advertising decreased from \$2,314,000 to \$1,082,000 in the three months ended September 30, 2006 as compared to the same period in 2005, and decreased from \$8,857,000 to \$7,671,000 for the nine months ended September 30, 2006 as compared to the same period in 2005. We expect fourth quarter advertising and promotional expenses to increase significantly in the fourth quarter, as noted above.

As described below under "Shurgard Same-Store Facilities," certain cost savings in the area of yellow page advertising and call center expenses will benefit the same-store facilities as these benefits are allocated among all the facilities in our portfolio.

50

Utility expenses increased 7.3% and 8.7% during the three and nine months ended September 30, 2006, due principally to higher energy costs. These levels of increases are expected to persist during the remainder of 2006.

Insurance expense increased 48.0% and 27.5% for the three and nine months ended September 30, 2006, reflecting significant increases in property insurance resulting primarily from the hurricanes experienced in 2005. These rate increases became effective with our policy year starting April 1, 2006. We expect to realize certain economies due to the merger with Shurgard and, accordingly, expect the increases to moderate in the fourth quarter of 2006 and the first quarter of 2007.

Telephone reservation center costs decreased 8.2% for the three months ended September 30, 2006 and increased 1.2% for the nine months ended September 30, 2006, compared to the same periods in 2005. In preparation for our seasonal rental period, we increased our staffing levels earlier this year compared to the same period in 2005, resulting in higher payroll costs. We began to realize certain benefits from the increased staffing through better conversion ratios and lower temporary staffing costs during the three months ended September 30, 2006. We expect to continue to realize such benefits through the remainder of 2006.

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

Edgar Filing: PUBLIC STORAGE INC /CA - Form 10-Q

For the Quarter Ended

	March 31	June 30	September 30	December 31
(Amounts in thousands, except for per square foot amounts)				
Total rental income:				
2006	\$ 208,228	\$ 214,832	\$ 221,386	
2005	\$ 198,059	\$ 203,302	\$ 208,745	\$ 208,272
Total cost of operations (excluding depreciation and amortization):				
2006	\$ 72,030	\$ 72,749	\$ 71,115	
2005	\$ 69,991	\$ 67,736	\$ 67,730	\$ 65,873
Property tax expense:				
2006	\$ 20,663	\$ 19,346	\$ 20,376	
2005	\$ 19,931	\$ 18,402	\$ 19,573	\$ 17,025
Media advertising expense:				
2006	\$ 3,978	\$ 2,611	\$ 1,002	
2005	\$ 3,588	\$ 2,955	\$ 2,314	\$ 2,141
REVPAF:				
2006	\$ 10.77	\$ 11.10	\$ 11.43	
2005	\$ 10.25	\$ 10.52	\$ 10.77	\$ 10.76
Weighted average realized annual rent per occupied square foot:				
2006	\$ 11.94	\$ 12.05	\$ 12.50	
2005	\$ 11.41	\$ 11.42	\$ 11.75	\$ 11.89
Weighted average occupancy levels for the period:				
2006	90.2%	92.1%	91.4%	
2005	89.9%	92.1%	91.7%	90.5%

51

ANALYSIS OF REGIONAL TRENDS

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

Three Months Ended September 30,			Nine Months En
2006	2005	Change	2006
(Amounts in thousands, except for per square foot			

SAME STORE FACILITIES OPERATING TRENDS

BY REGION

Rental income:

Southern California (126



Edgar Filing: PUBLIC STORAGE INC /CA - Form 10-Q

facilities).....	\$ 35,871	\$ 34,066	5.3%	\$ 105,231	\$
Northern California (127 facilities).....	26,822	25,292	6.0%	77,983	
Texas (149 facilities).....	19,625	18,287	7.3%	56,772	
Florida (130 facilities).....	22,793	21,057	8.2%	67,347	
Illinois (91 facilities).....	16,577	15,635	6.0%	47,556	
Georgia (58 facilities).....	7,671	7,013	9.4%	22,285	
All other states (585 facilities)	92,027	87,395	5.3%	267,272	
	-----	-----	-----	-----	-----
Total rental income.....	221,386	208,745	6.1%	644,446	
Cost of operations before depreciation and amortization:					
Southern California.....	7,530	7,216	4.4%	23,905	
Northern California.....	6,747	6,303	7.0%	20,485	
Texas.....	8,519	8,091	5.3%	25,576	
Florida.....	7,818	7,199	8.6%	22,567	
Illinois.....	6,356	6,245	1.8%	20,892	
Georgia.....	2,452	2,315	5.9%	7,503	
All other states.....	31,693	30,361	4.4%	94,966	
	-----	-----	-----	-----	-----
Total cost of operations.....	71,115	67,730	5.0%	215,894	
Net operating income before depreciation and amortization:					
Southern California.....	28,341	26,850	5.6%	81,326	
Northern California.....	20,075	18,989	5.7%	57,498	
Texas.....	11,106	10,196	8.9%	31,196	
Florida.....	14,975	13,858	8.1%	44,780	
Illinois.....	10,221	9,390	8.8%	26,664	
Georgia.....	5,219	4,698	11.1%	14,782	
All other states.....	60,334	57,034	5.8%	172,306	
	-----	-----	-----	-----	-----
Total net operating income before depreciation and amortization....	\$ 150,271	\$ 141,015	6.6%	\$ 428,552	\$
Weighted average occupancy:					
Southern California.....	91.0%	92.2%	(1.3)%	91.4%	
Northern California.....	90.5%	91.0%	(0.5)%	90.6%	
Texas.....	91.4%	90.8%	0.7%	91.1%	
Florida.....	92.7%	94.4%	(1.8)%	93.3%	
Illinois.....	90.9%	90.8%	0.1%	89.8%	
Georgia.....	92.5%	92.8%	(0.3)%	92.9%	
All other states.....	91.3%	91.5%	(0.2)%	90.9%	
	-----	-----	-----	-----	-----
Total weighted average occupancy....	91.4%	91.7%	(0.3)%	91.2%	
REVPAF:					
Southern California.....	\$ 17.44	\$ 16.55	5.4%	\$ 17.06	\$
Northern California.....	14.85	14.00	6.1%	14.40	
Texas.....	8.06	7.53	7.0%	7.78	
Florida.....	11.66	10.76	8.3%	11.49	
Illinois.....	11.39	10.72	6.2%	10.90	
Georgia.....	8.61	7.91	9.0%	8.35	
All other states.....	10.46	9.93	5.4%	10.14	
	-----	-----	-----	-----	-----
Total REVPAF.....	\$ 11.43	\$ 10.77	6.1%	\$ 11.10	\$

Edgar Filing: PUBLIC STORAGE INC /CA - Form 10-Q

SAME STORE FACILITIES OPERATING  
TRENDS BY REGION (CONTINUED)

	Three Months Ended September 30,			Nine Months En	
	2006	2005	Change	2006	
Realized annual rent per occupied square foot:					
Southern California.....	\$ 19.16	\$ 17.95	6.7%	\$ 18.67	\$
Northern California.....	16.41	15.38	6.7%	15.89	
Texas.....	8.82	8.29	6.4%	8.54	
Florida.....	12.57	11.40	10.3%	12.31	
Illinois.....	12.53	11.81	6.1%	12.14	
Georgia.....	9.31	8.53	9.1%	8.99	
All other states.....	11.45	10.85	5.5%	11.15	
Total realized rent per square foot.	\$ 12.50	\$ 11.75	6.4%	\$ 12.17	\$
In place annual rent per occupied square foot at September 30:					
Southern California.....				\$ 20.54	\$
Northern California.....				17.61	
Texas.....				9.56	
Florida.....				13.58	
Illinois.....				13.61	
Georgia.....				10.21	
All other states.....				12.38	
Total in place rent per occupied square foot.....				\$ 13.51	\$

Shurgard Domestic Operating Data

In the merger with Shurgard, we acquired 487 facilities located in 21 states with an aggregate of 32.1 million net rentable square feet. The following chart sets forth the operations of the Shurgard Facilities from August 22, 2006 through September 30, 2006, the period operated under Public Storage and consolidated in our financial statements (amounts in thousands):

53

	From August 22, 2006 through September 30, 2006
Rental income:	
Same Store - 383 facilities.....	\$ 31,237
Non-Same Store - 104 facilities.....	7,704
Total rental income.....	38,941
Cost of operations (excluding depreciation):	
Same Store.....	9,582

Edgar Filing: PUBLIC STORAGE INC /CA - Form 10-Q

Non-Same Store.....	2,820	
	-----	
Total cost of operations.....	12,402	
Net operating income before depreciation (a):		
Same Store.....	21,655	
Non-Same Store.....	4,884	
	-----	
Total net operating income before depreciation.....	26,539	
Depreciation and amortization.....	(48,032)	
	-----	
Net operating income.....	\$ (21,493)	
	=====	
Weighted average square foot occupancy during the period:.....	84.4%	
Weighted average realized annual rent per occupied square foot for the period:.....	\$ 12.89	
In place annual rent per occupied square foot at September 30:.....	\$ 13.86	

(a) Total net operating income before depreciation, which is a non-GAAP measure, for our commercial property segment is presented in Note 13 to our condensed consolidated financial statements, "Segment Information," which includes a reconciliation of net operating income before depreciation for this segment to our consolidated net income.

As noted above, our Same-Store facilities had occupancies of approximately 91.4% at September 30, 2006, as compared to 84.4% for the acquired Shurgard Same Store portfolio. It is our objective to close this occupancy gap in order to increase REVPAF. In attempting to accomplish this objective, we have significantly expanded our domestic pricing, promotional, and media programs, and aggregate media costs will more than double in the fourth quarter versus the aggregate level of spending incurred in the fourth quarter of 2005. There can be no assurance that we will meet our objectives or that any increase in occupancies will not be offset by lower realized rent per occupied square foot either due to promotional discounts or lower monthly rent in the acquired Shurgard facilities or the Same Store facilities.

The operating data presented in the table below reflects the historical data through August 22, 2006, the period for which the facilities were operated under Shurgard combined with the historical data from August 22, 2006 through September 30, 2006, the period operated under Public Storage. Accordingly, the data presented below does not reflect the actual results included in our operations for the three and nine months ended September 30, 2006 and 2005 and does not purport to project results of operations for any future date or period. We have applied our definition of what qualifies as a Same Store and, as a result, the number of properties included in the Shurgard Domestic Same Store portfolio has decreased from 462 facilities (as reported by Shurgard in the second quarter of 2006) to 383 facilities as is currently being reported.

Selected Operating Data for the 383 facilities  
 -----  
 operated by Shurgard on a stabilized basis since  
 -----

Edgar Filing: PUBLIC STORAGE INC /CA - Form 10-Q

January 1, 2004 ("Shurgard Domestic Same Store

Facilities"): (a)

	Three Months Ended September 30,		
	2006	2005	Percentage Change
(Dollar amounts in thousands, except as otherwise indicated)			
Revenues:			
Rental income.....	\$ 70,625	\$ 68,232	3.5%
Late charges and administrative fees collected	2,667	2,567	3.9%
Total revenues (b).....	73,292	70,799	3.5%
Cost of operations (excluding depreciation):			
Property taxes .....	7,107	6,489	9.5%
Payroll expense.....	11,620	12,014	(3.3)%
Advertising and promotion.....	2,045	1,975	3.5%
Utilities.....	2,215	2,108	5.1%
Repairs and maintenance.....	1,505	1,733	(13.2)%
Property insurance.....	565	377	49.9%
Other costs of management.....	2,559	2,579	(0.8)%
Total cost of operations (b).....	27,616	27,275	1.3%
Net operating income (excluding depreciation) (c)	\$ 45,676	\$ 43,524	4.9%
Gross margin (before depreciation).....	62.3%	61.5%	1.3%
Weighted average for the period:			
Square foot occupancy (d).....	85.9%	88.1%	(2.5)%
Realized annual rent per occupied square foot (e)	\$ 13.28	\$ 12.51	6.2%
REVPAF (f) (g).....	\$ 11.41	\$ 11.02	3.5%
Weighted average at September 30:			
Square foot occupancy.....			
Total net rentable square feet (in thousands).....			

(a) Operating data reflects the operations of these facilities without regard to the time period in which Public Storage owned the facilities; only the amounts for the period August 23, 2006 through September 30, 2006 are included in our consolidated operating results, totaling \$31,237,000 in revenues and \$9,582,000 in cost of operations.

(b) Revenues and cost of operations do not include ancillary revenues and expenses generated at the facilities with respect to tenant reinsurance, and retail sales and truck rentals. "Other costs of management" included in cost of operations principally represents all the indirect costs incurred in the operations of the facilities. Indirect costs principally include supervisory costs and corporate overhead cost incurred to support the operating activities of the facilities. These amounts presented herein will not necessarily compare to amounts previously presented by Shurgard in its public reporting due to differences in classification of revenues and expenses, including tenant reinsurance, retail sales and truck rental activities which are

## Edgar Filing: PUBLIC STORAGE INC /CA - Form 10-Q

included on our income statement under "ancillary operations" but were previously presented by Shurgard as self-storage revenue and operating expenses.

- (c) Net operating income (before depreciation) or "NOI" is a non-GAAP (generally accepted accounting principles) financial measure that excludes the impact of depreciation expense. Although depreciation is an operating expense, we believe that NOI is a meaningful measure of operating performance, because we utilize NOI in making decisions with respect to capital allocations, in determining current property values, segment performance, and comparing period-to-period and market-to-market property operating results. NOI is not a substitute for net operating income after depreciation in evaluating our operating results. We have not presented depreciation expense for these facilities because the depreciation expense is based upon historical cost, which is substantially different before the merger and after.
- (d) Square foot occupancies represent weighted average occupancy levels over the entire period.

55

- (e) Realized annual rent per occupied square foot is computed by annualizing the result of dividing rental income by the weighted average occupied square footage for the period. Realized annual rent per occupied square foot takes into consideration promotional discounts and other costs that reduce rental income from the contractual amounts due.
- (f) Annualized rental income per available square foot ("REVPAF") represents annualized rental income divided by total available net rentable square feet.
- (g) Late charges and administrative fees are excluded from the computation of realized annual rent per occupied square foot and REVPAF because exclusion of these amounts provides a better measure of our ongoing level of revenue, by excluding the volatility of late charges, which are dependent principally upon the level of tenant delinquency, and administrative fees, which are dependent principally upon the absolute level of move-ins for a period.

On the date of the merger, we successfully installed our real-time property operation system at all U.S. Shurgard locations. As a result, these facilities are integrated into our national call center, website, and management structure. The integration of these facilities into our operations should have additional benefits and cost savings.

Beginning January 2007, all field personnel will be under a revised Public Storage compensation and benefit plan. The cost savings from implementing the new plan along with a more efficient staffing mix are expected to be in excess of \$5 million per year.

Marketing costs, exclusive of media, will be lower as a result of combining Yellow Page advertising and terminating Shurgard's marketing programs. There will be approximately \$5 million in savings that will phase in over the next year over the level of yellow page expenses incurred by Shurgard, resulting in lower per-property expenses for all of the facilities in our portfolio as costs are spread over a larger base. We expect property tax expense to be higher than that experienced by Shurgard due to higher assessments following the merger.

## Edgar Filing: PUBLIC STORAGE INC /CA - Form 10-Q

### SHURGARD EUROPEAN OPERATING DATA

In the merger with Shurgard, we acquired 160 facilities located in seven European countries with an aggregate of 8,385,000 net rentable square feet. The following chart sets forth the operations of the Shurgard Facilities from August 22, 2006 through September 30, 2006, the period operated under Public Storage and consolidated in our financial statements (amounts in thousands):

	From August 22, 2006 through September 30, 2006
-----	
Rental income:	
Same Store - 96 facilities.....	\$ 12,012
Non-Same Store - 64 facilities.....	5,336
-----	
Total rental income.....	17,348
Cost of operations (excluding depreciation):	
Same Store.....	5,048
Non-Same Store.....	3,476
-----	
Total cost of operations.....	8,524
Net operating income before depreciation (a):	
Same Store.....	6,964
Non-Same Store.....	1,860
-----	
Total net operating income before depreciation.....	8,824
Depreciation and amortization.....	(15,020)
-----	
Net operating loss.....	\$ (6,196)
=====	
Weighted average square foot occupancy during the period:.....	81.9%
Weighted average realized annual rent per occupied square foot for the period:.....	\$ 23.13
In place annual rent per occupied square foot at September 30:.....	\$ 22.77

(a) Total net operating income before depreciation, which is a non-GAAP measure, for our commercial property segment is presented in Note 13 to our condensed consolidated financial statements, "Segment Information," which includes a reconciliation of net operating income before depreciation for this segment to our consolidated net income.

The operating data presented in the table below reflect the historical data through August 22, 2006, the period for which the facilities were operated under Shurgard combined with the historical data from August 22, 2006 through September 30, 2006, the period operated under Public Storage. Accordingly, the data presented below does not reflect the actual results included in our operations for the three and nine months ended September 30, 2006 and 2005. We have applied our definition of what qualifies as a Same Store. As a result, the number of properties included in the Shurgard European Same Store portfolio has decreased from 123 facilities (as reported by Shurgard in the second quarter of 2006) to 96 facilities as is currently being reported.

Edgar Filing: PUBLIC STORAGE INC /CA - Form 10-Q

Selected Operating Data for the 96 facilities  
operated by Shurgard Europe on a stabilized basis  
since January 1, 2004 ("Europe Same Store  
Facilities"): (a)

	Three Months Ended September 30,		
	2006	2005	Percentage Change
(Dollar amounts in thousands, except weighted average constant exchange rate)			
Revenues:			
Rental income.....	\$ 27,539	\$ 24,535	12.2%
Late charges and administrative fees collected	266	251	6.0%
Total revenues (c).....	27,805	24,786	12.2%
Cost of operations (excluding depreciation):			
Property taxes .....	1,261	1,174	7.4%
Payroll expense.....	5,198	5,189	0.2%
Advertising and promotion.....	1,179	1,689	(30.2)%
Utilities.....	695	565	23.0%
Repairs and maintenance.....	898	807	11.3%
Property insurance.....	346	403	(14.1)%
Leasehold expense.....	635	756	(16.0)%
Other costs of management.....	2,396	2,615	(8.4)%
Total cost of operations (c).....	12,608	13,198	(4.5)%
Net operating income (excluding depreciation) (d)	\$ 15,197	\$ 11,588	31.1%
Gross margin (before depreciation).....	54.7%	46.8%	16.9%
Weighted average for the period:			
Square foot occupancy (e).....	86.7%	81.3%	6.6%
Realized annual rent per occupied square foot (f)	\$ 24.01	\$ 22.81	5.3%
REVPAF (g) (h).....	\$ 20.82	\$ 18.54	12.3%
Weighted average at September 30:			
Square foot occupancy.....			
In place annual rent per occupied square foot (i)			
Total net rentable square feet (in thousands).....			

(a) Operating data reflects the operations of these facilities without regard to the time period in which Public Storage owned the facilities; only the amounts for the period August 23, 2006 through September 30, 2006 are included in our consolidated operating results.

(b) Amounts for all periods have been translated from local currencies to U.S. dollars at a constant exchange rate of 1.25 US Dollars to Euros.

(c) Revenues and cost of operations do not include ancillary revenues and expenses generated at the facilities with respect to tenant reinsurance

## Edgar Filing: PUBLIC STORAGE INC /CA - Form 10-Q

and retail sales. "Other costs of management" included in cost of operations principally represents all the indirect costs incurred in the operations of the facilities. Indirect costs principally include supervisory costs and corporate overhead cost incurred to support the operating activities of the facilities. These amounts presented herein will not necessary compare to amounts previously presented by Shurgard in its public reporting due to differences in classification of revenues and expenses, including tenant reinsurance, retail sales, and truck rental activities which are included on our income statement under "ancillary operations" but were previously presented by Shurgard as self-storage revenue and operating expenses.

57

- (d) Net operating income (before depreciation) or "NOI" is a non-GAAP (generally accepted accounting principles) financial measure that excludes the impact of depreciation expense. Although depreciation is an operating expense, we believe that NOI is a meaningful measure of operating performance, because we utilize NOI in making decisions with respect to capital allocations, in determining current property values, segment performance, and comparing period-to-period and market-to-market property operating results. NOI is not a substitute for net operating income after depreciation in evaluating our operating results.
- (e) Square foot occupancies represent weighted average occupancy levels over the entire period.
- (f) Realized annual rent per occupied square foot is computed by annualizing the result of dividing rental income by the weighted average occupied square footage for the period. Realized annual rent per occupied square foot takes into consideration promotional discounts and other costs that reduce rental income from the contractual amounts due.
- (g) Annualized rental income per available square foot ("REVPAF") represents annualized rental income divided by total available net rentable square feet.
- (h) Late charges and administrative fees are excluded from the computation of realized annual rent per occupied square foot and REVPAF because exclusion of these amounts provides a better measure of our ongoing level of revenue, by excluding the volatility of late charges, which are dependent principally upon the level of tenant delinquency, and administrative fees, which are dependent principally upon the absolute level of move-ins for a period.
- (i) In place annual rent per occupied square foot represents annualized contractual rents per occupied square foot without reductions for promotional discounts, and excludes late charges and administrative fees.

The European Same Store properties' NOI growth of over 30% significantly exceeded our expectations. The European team is selectively adapting various operating strategies we use in the United States and incorporating them into their operating model.

### SELF-STORAGE OPERATIONS - ACQUIRED FACILITIES

During 2004, 2005 and the first nine months of 2006, we acquired a total of 89 self-storage facilities containing 6,383,000 net rentable square



Edgar Filing: PUBLIC STORAGE INC /CA - Form 10-Q

feet. The following table summarizes operating data with respect to these facilities.

ACQUIRED SELF-STORAGE FACILITIES

	Three Months Ended September 30,			Ni
	2006	2005	Change	
(Dollar amounts in thousands, ex				
Rental income:				
Self-storage facilities acquired in 2006.....	\$ 2,168	\$ -	\$ 2,168	\$
Self-storage facilities acquired in 2005.....	6,537	2,748	3,789	
Self-storage facilities acquired in 2004.....	8,749	7,926	823	
Total rental income.....	17,454	10,674	6,780	
Cost of operations before depreciation and amortization :				
Self-storage facilities acquired in 2006.....	1,061	-	1,061	
Self-storage facilities acquired in 2005.....	2,424	1,195	1,229	
Self-storage facilities acquired in 2004.....	3,120	3,005	115	
Total cost of operations.....	6,605	4,200	2,405	
Net operating income before depreciation and amortization:				
Self-storage facilities acquired in 2006.....	1,107	-	1,107	
Self-storage facilities acquired in 2005.....	4,113	1,553	2,560	
Self-storage facilities acquired in 2004.....	5,629	4,921	708	
Total net operating income before depreciation and amortization (a).....	10,849	6,474	4,375	
Depreciation and amortization.....	(4,649)	(2,508)	(2,141)	
Net operating income.....	\$ 6,200	\$ 3,966	\$ 2,234	\$

58

ACQUIRED SELF-STORAGE FACILITIES (Continued)

	Three Months Ended September 30,			Ni
	2006	2005	Change	
Weighted average square foot occupancy during the period:				
Self-storage facilities acquired in 2006.....	73.3%	-	-	
Self-storage facilities acquired in 2005.....	86.3%	87.4%	(1.3)%	
Self-storage facilities acquired in 2004.....	89.6%	90.2%	(0.7)%	
	86.1%	89.4%	(3.7)%	

Edgar Filing: PUBLIC STORAGE INC /CA - Form 10-Q

Weighted average realized annual rent per occupied square foot for the period (b):

Self-storage facilities acquired in 2006.....	\$ 12.88	\$ -	-	\$
Self-storage facilities acquired in 2005.....	12.07	10.05	20.1%	
Self-storage facilities acquired in 2004.....	12.08	10.88	11.0%	
	-----	-----	-----	-----
	\$ 12.17	\$ 10.66	14.2%	\$
	=====	=====	=====	=====

In place annual rent per occupied square foot at September 30 (c):

Self-storage facilities acquired in 2006.....				\$
Self-storage facilities acquired in 2005.....				
Self-storage facilities acquired in 2004.....				

Number of Facilities at September 30:

2006.....				
2005.....				
2004.....				

Net rentable square feet at September 30:

Self-storage facilities acquired in 2006.....				
Self-storage facilities acquired in 2005.....				
Self-storage facilities acquired in 2004 (d)..				

Cumulative acquisition cost at September 30:

Self-storage facilities acquired in 2006.....				\$
Self-storage facilities acquired in 2005.....				
Self-storage facilities acquired in 2004 (d)..				

(a) Total net operating income before depreciation and amortization, which is a non-GAAP measure, for our acquired self-storage facilities represents a portion of our total self-storage segment's net operating income before depreciation and amortization, and is reconciled to the segment total in the table "self-storage operations summary" above. A reconciliation of our total self-storage segment's net operating income before depreciation and amortization to consolidated net income is included in Note 13 to our September 30, 2006 condensed consolidated financial statements, "Segment Information."

(b) Realized annual rent per occupied square foot is computed by dividing rental income, prior to late charges and administrative fees, by the weighted average occupied square footage for the period. Realized annual rent per occupied square foot takes into consideration promotional discounts, credit card fees and other costs that reduce rental income from the contractual amounts due.

(c) In place annual rent per occupied square foot represents annualized contractual rents per occupied square foot without reductions for promotional discounts, and excludes late charges and administrative fees.

## Edgar Filing: PUBLIC STORAGE INC /CA - Form 10-Q

- (d) During 2005, we expanded one of the 2004 acquisitions, adding 12,000 net rentable square feet at a cost of \$1,314,000.

59

The 2005 and 2006 acquisitions were acquired at various dates throughout each period. Accordingly, rental income, cost of operations, depreciation, net operating income, weighted average square foot occupancies and realized rents per square foot represent the operating results for the partial period that we owned the facilities during the year acquired. In addition, in place rents per occupied square foot at September 30, 2006 and 2005, reflect the amounts for those facilities we owned at each of those respective dates.

During 2004, we acquired a total of 45 self-storage facilities with cumulative acquisition costs of approximately \$260,801,000, containing an aggregate of approximately 3,121,000 net rentable square feet and are located principally in the Buffalo, Dallas, Miami, Milwaukee, and Minneapolis metropolitan areas.

During 2005, we acquired a total of 32 self-storage facilities, principally in single-property transactions, for an aggregate cost of \$254,549,000. These facilities contain in the aggregate approximately 2,390,000 net rentable square feet and are located principally in the Atlanta, Chicago, Miami, and New York metropolitan areas.

For the nine months ended September 30, 2006, we acquired a total of 12 self-storage facilities, each in a single-property transaction, containing an aggregate of approximately 872,000 net rentable square feet for an aggregate cost of \$103,544,000 located in California, Florida, Illinois, New York, Virginia, New Jersey, Delaware, Georgia and Colorado.

We believe our presence in and knowledge of substantially all of the major markets in the United States enhances our ability to identify attractive acquisition opportunities and capitalize on the overall fragmentation in the storage industry. Our acquisitions consist of facilities that have been operating for a number of years as well as newly constructed facilities that were in the process of filling up to stabilized occupancy levels. In either case, we have been able to leverage off of our operating strategies and improve the occupancy levels of the facilities, or with respect to the newly developed facilities we have been able to accelerate the fill-up pace.

We expect that our acquisitions will continue to provide earnings growth during the remainder of 2006 as these facilities continue to improve their occupancy levels as well as realized rental rates.

### SELF-STORAGE OPERATIONS - EXPANSION FACILITIES

Our expansion facilities consist of (i) 53 self-storage facilities that we have owned for a number of years and have recently expanded, or are in the process of expanding, the amount of square footage available for rent combined with (ii) eight self-storage facilities located in New Orleans that were heavily impacted by Hurricane Katrina during 2005. The 53 self-storage facilities are generally older facilities that are located in prime locations where we have added additional space by either constructing new buildings on available land at the existing site or by demolishing existing single story buildings and rebuilding multi-story buildings in their place.

The operating results of these 53 expansion facilities and the eight facilities located in New Orleans are not comparable on a year over year basis due to the addition of square footage or the damage caused by the hurricane, in the case of the New Orleans facilities. The operating results for these

Edgar Filing: PUBLIC STORAGE INC /CA - Form 10-Q

facilities are presented in the table below.

60

EXPANSION SELF-STORAGE FACILITIES

	Three Months Ended September 30,		
	2006	2005	Change
<b>Rental income:</b>			
New Orleans facilities (a) .....	\$ 1,401	\$ 1,031	\$ 370
Other expansion facilities.....	12,581	10,719	1,862
Total rental income.....	13,982	11,750	2,232
<b>Cost of operations before depreciation:</b>			
New Orleans facilities.....	456	500	(44)
Other expansion facilities.....	3,764	3,533	231
Total cost of operations.....	4,220	4,033	187
<b>Net operating income before depreciation:</b>			
New Orleans facilities.....	945	531	414
Other expansion facilities.....	8,817	7,186	1,631
Total net operating income before depreciation (b)	9,762	7,717	2,045
Depreciation.....	(3,765)	(2,739)	(1,026)
Net operating income.....	\$ 5,997	\$ 4,978	\$ 1,019
<b>Weighted average square foot occupancy during the period:</b>			
New Orleans facilities (c).....	82.1%	91.7%	(10.5)%
Other expansion facilities.....	83.5%	87.7%	(4.8)%
	83.4%	87.4%	(4.6)%
<b>Weighted average realized rent per occupied square foot during the period (d):</b>			
New Orleans facilities (c) .....	\$ 9.90	\$ 8.16	21.3%
Other expansion facilities.....	12.84	11.87	8.2%
	\$ 12.62	\$ 11.56	9.2%
<b>In place annual rent per occupied square foot at September 30 (e):</b>			
New Orleans facilities (c) .....			

Edgar Filing: PUBLIC STORAGE INC /CA - Form 10-Q

Other expansion facilities.....

Number of Facilities at September 30:

-----  
New Orleans facilities.....  
Other expansion facilities.....

Net rentable square feet (in thousands,

-----  
at end of period) (f):  
-----

New Orleans facilities.....  
Other expansion facilities.....

- (a) Rental income for the New Orleans Facilities for the three and nine months ended September 30, 2006 includes \$277,000 and \$1,217,000, respectively, in business interruption proceeds we expect to receive from our insurers, relative to losses occurring in each respective period (none for the same periods in 2005).

61

- (b) Total net operating income before depreciation, which is a non-GAAP measure, for our expansion self-storage facilities represents a portion of our total self-storage segment's net operating income before depreciation, and is reconciled to the segment total in the table "self-storage operations summary" above. A reconciliation of our total self-storage segment's net operating income before depreciation to consolidated net income is included in Note 13 to our September 30, 2006 condensed consolidated financial statements, "Segment Information."
- (c) Occupied and available square footage excludes the impact of units taken offline due to hurricane damage, where such amounts are factored in to the computations of weighted average square foot occupancy, weighted average realized rent per occupied square foot, and in place annual rent per occupied square foot.
- (d) Realized annual rent per occupied square foot is computed by dividing rental income, prior to late charges and administrative fees, by the weighted average occupied square footage for the period. Realized annual rent per occupied square foot takes into consideration promotional discounts, credit card fees and other costs that reduce rental income from the contractual amounts due. Realized rent per square foot excludes the impact of \$277,000 and \$1,217,000 in business interruption proceeds we expect to receive from our insurers relative to the New Orleans facilities for the three and nine months ended September 30, 2006, respectively (none for the same periods in 2005).
- (e) In place annual rent per occupied square foot represents annualized contractual rents per occupied square foot without reductions for promotional discounts, and excludes late charges and administrative

## Edgar Filing: PUBLIC STORAGE INC /CA - Form 10-Q

fees.

- (f) Square footage excludes 299,000 net rentable containerized storage space initially developed for the containerized storage business at September 30, 2006, but includes square footage taken offline due to hurricane damage.

All of the New Orleans facilities were closed for operations for several weeks following the hurricane; however, all but two of these facilities have since reopened. The six that are operating are not operating at full capacity, as many units are unavailable for lease due to damage. The two facilities that remain closed will not be able to reopen at all without substantial restoration and repair work. Notwithstanding that six of our facilities in New Orleans are currently operating, we believe that the indirect economic effects of the hurricane on the city may have a negative impact on our facilities' operating results, and these effects are expected to continue for an indeterminate time period. Included in revenues for the three and nine months ended September 30, 2006 are \$277,000 and \$1,217,000, respectively, in expected business interruption proceeds for these facilities, representing the loss of business for the nine months ended September 30, 2006.

We expect that the Expansion Facilities, other than the New Orleans facilities, will continue to provide growth to our earnings during the remainder of 2006 as we continue to rent the newly added vacant space. The weighted average occupancy level of these facilities was 83.5%, and 81.0% for the three and nine months ended September 30, 2006, respectively. For the three and nine months ended September 30, 2005, the weighted average occupancy level of these facilities was 87.7% and 85.3%, respectively.

We expect that we will continue to redevelop additional facilities; at September 30, 2006, we have five projects with an aggregate cost of \$18,883,000 to convert the containerized storage space into self-storage space and 44 other expansion and repackaging projects to enhance the visual appeal of our facilities or increase their net rentable space at an aggregate cost of \$219,232,000. These activities will increase our self-storage space by an aggregate of 2,750,000 net rentable square feet and will result in short-term dilution to earnings. However, we believe that expansion of our existing self-storage facilities in markets that have unmet storage demand, and improving our existing facilities' competitive position through enhancing their visual appeal, provide an important means to improve the Company's earnings. Further, the construction cost for these expansions is generally lower on a per-square foot basis than the development of a new facility, resulting in a higher yield potential on invested capital. There can be no assurance about the future level of such expansion and enhancement opportunities, and these projects are subject to contingencies.

### SELF-STORAGE OPERATIONS - DEVELOPED FACILITIES

We have 44 newly developed self-storage facilities, and 17 facilities that were developed to contain both self-storage and containerized storage at the same location ("Combination Facilities") that have not been operating at a stabilized level of operations since January 1, 2004. At September 30, 2006, these newly developed facilities have an aggregate of 5,102,000 net rentable

square feet of self-storage space and 125,000 net rentable square feet of industrial space developed originally for our containerized storage business. Aggregate development cost for these 61 facilities was approximately

## Edgar Filing: PUBLIC STORAGE INC /CA - Form 10-Q

\$539,174,000 at September 30, 2006. The operating results of the self-storage facilities and Combination Facilities are reflected in the Self-Storage Operations table under the caption, "Developed Facilities." These facilities are not included in the "Same Store" portfolio because their operations have not been stabilized.

The following table sets forth the operating results and selected operating data with respect to the Developed Facilities:

DEVELOPED SELF-STORAGE FACILITIES	Three Months Ended September 30,			Ni
	2006	2005	Change	200
	(Amounts in thousands, except per square foot)			
Rental income:				
Self-storage facilities opened in 2006.....	\$ 375	\$ -	\$ 375	\$
Self-storage facilities opened in 2005.....	784	154	630	1
Self-storage facilities opened in 2004.....	2,047	1,505	542	5
Self-storage facilities opened in 2003 and 2002	7,322	6,452	870	20
Combination facilities.....	5,516	4,422	1,094	15
Total rental income.....	16,044	12,533	3,511	43
Cost of operations before depreciation:				
Self-storage facilities opened in 2006.....	344	-	344	
Self-storage facilities opened in 2005.....	381	187	194	1
Self-storage facilities opened in 2004.....	641	525	116	1
Self-storage facilities opened in 2003 and 2002	2,161	2,096	65	6
Combination facilities.....	1,899	1,502	397	5
Total cost of operations before depreciation	5,426	4,310	1,116	15
Net operating income before depreciation:				
Self-storage facilities opened in 2006.....	31	-	31	
Self-storage facilities opened in 2005.....	403	(33)	436	
Self-storage facilities opened in 2004.....	1,406	980	426	3
Self-storage facilities opened in 2003 and 2002	5,161	4,356	805	14
Combination facilities.....	3,617	2,920	697	9
Net operating income before depreciation (a)	10,618	8,223	2,395	28
Depreciation.....	(3,857)	(3,296)	(561)	(10)
Net operating income.....	\$ 6,761	\$ 4,927	\$ 1,834	\$ 17
Weighted average square foot occupancy during the period:				
Self-storage facilities opened in 2006.....	35.5%	-	-	26
Self-storage facilities opened in 2005.....	52.8%	29.1%	81.4%	42
Self-storage facilities opened in 2004.....	89.5%	82.0%	9.1%	87
Self-storage facilities opened in 2003 and 2002	91.9%	91.9%	0.0%	92
Combination facilities.....	80.6%	82.1%	(1.8)%	77
	81.0%	82.3%	(1.6)%	79
Weighted average realized rent per occupied square foot during the period (b):				
Self-storage facilities opened in 2006.....	\$ 13.97	-	-	\$ 11.

Edgar Filing: PUBLIC STORAGE INC /CA - Form 10-Q

Self-storage facilities opened in 2005.....	12.15	8.02	51.5%	11.
Self-storage facilities opened in 2004.....	16.79	14.43	16.4%	16.
Self-storage facilities opened in 2003 and 2002	15.69	13.88	13.0%	14.
Combination facilities.....	13.71	12.84	6.8%	13.
	-----	-----	-----	-----
	\$ 14.78	\$ 13.42	10.1%	\$ 14.
	=====	=====	=====	=====

63

DEVELOPED SELF-STORAGE FACILITIES  
(continued)

	Three Months Ended September 30,		Change	Ni
	2006	2005		
In place annual rent per occupied square foot at ----- September 30 (c):				200
	(Amounts in thousands, except per square foot			
Self-storage facilities opened in 2006.....				\$ 23.
Self-storage facilities opened in 2005.....				14.
Self-storage facilities opened in 2004.....				17.
Self-storage facilities opened in 2003 and 2002				16.
Combination facilities.....				14.
				-----
				\$ 16.
				=====
Number of facilities at September 30:				
Self-storage facilities opened in 2006.....				
Self-storage facilities opened in 2005.....				
Self-storage facilities opened in 2004.....				
Self-storage facilities opened in 2003 and 2002				
Combination facilities.....				
				-----
				=====
Square Footage at September 30:				
Self-storage facilities opened in 2006.....				1
Self-storage facilities opened in 2005.....				1
Self-storage facilities opened in 2004.....				
Self-storage facilities opened in 2003 and 2002				
Combination facilities (d).....				5
				-----
				=====
Cumulative development cost at September 30:				
Self-storage facilities opened in 2006.....				\$ 49
Self-storage facilities opened in 2005.....				37
Self-storage facilities opened in 2004.....				60
Self-storage facilities opened in 2003 and 2002				211
Combination facilities (d).....				179
				-----



- (a) Total net operating income before depreciation, which is a non-GAAP measure, for our developed self-storage facilities represents a portion of our total self-storage segment's net operating income before depreciation, and is denoted in the table "self-storage operations summary" above. A reconciliation of our total self-storage segment's net operating income before depreciation to consolidated net income is included in Note 13 to our September 30, 2006 condensed consolidated financial statements, "Segment Information."
- (b) Realized annual rent per occupied square foot is computed by dividing rental income, prior to late charges and administrative fees, by the weighted average occupied square footage for the period. Realized annual rent per occupied square foot takes into consideration promotional discounts, credit card fees and other costs that reduce rental income from the contractual amounts due, and therefore amounts for the three and nine months ended September 30, 2006 and 2005 may not be comparable to the same periods in prior years for self-storage facilities opened in 2006 and 2005. We typically provide significant promotional discounts to new tenants when a facility first opens for operations. As facilities reach a stabilized occupancy level, the amounts of discounts given will be reduced significantly.
- (c) In place annual rent per occupied square foot represents annualized contractual rents per occupied square foot without reductions for promotional discounts, and excludes late charges and administrative fees.
- (d) Square footages exclude industrial space developed for containerized storage activities totaling 125,000 net rentable square feet at September 30, 2006. Since January 1, 2003, we have converted industrial space no longer used by the discontinued containerized storage business into 1,553,000 net rentable square feet of traditional self-storage space, at an aggregate cost of \$25,964,000.

64

Unlike many other forms of real estate, we are unable to pre-lease our newly developed facilities due to the nature of our tenants. Accordingly, at the time a newly developed facility first opens for operation the facility is entirely vacant generating no rental income. Historically, we estimated that on average it takes approximately 24 to 36 months for a newly developed facility to fill up and reach a targeted occupancy level of approximately 90%.

As these facilities approach the targeted occupancy level of approximately 90%, rates are increased, resulting in further improvement in net operating income as the existing tenants, which moved in at lower rates, have their rates increased or are replaced by new tenants paying higher rates. This process of reaching stabilized rental rates can take approximately another 12 to 24 months following the time when the facilities reach a stabilized occupancy level. In addition, move-in discounts have a more pronounced effect upon realized rental rates for the newly developed facilities, because such facilities tend to have a higher ratio of newer tenants.

Property operating expenses are substantially fixed, consisting primarily of payroll, property taxes, utilities, and marketing costs. The rental revenue of a newly developed facility will generally not cover its property

## Edgar Filing: PUBLIC STORAGE INC /CA - Form 10-Q

operating expenses (excluding depreciation) until the facility has reached an occupancy level of approximately 30% to 35%. However, at that occupancy level, the rental revenues from the facility are still not sufficient to cover related depreciation expense and cost of capital with respect to the facility's development cost. During construction of the self-storage facility, we capitalize interest costs and include such cost as part of the overall development cost of the facility. Once the facility is opened for operations interest is no longer capitalized.

The annualized yield on costs for these facilities for the nine months ended September 30, 2006, based on net operating income before depreciation, was approximately 7.0%, which is lower than our ultimate yield expectations. We expect these yields to increase as these facilities reach stabilization of both occupancy levels and realized rents. Properties that were developed before 2005 have contributed greatly to our earnings growth. The growth in properties developed in 2004 was principally due to occupancy growth, and growth for properties developed in 2003 and 2002 were due principally to rate increases. We expect that these facilities will continue to provide growth to our earnings.

Development of self-storage facilities causes short-term earnings dilution because, as mentioned above, of the extended time to stabilize a self-storage facility. We have developed self-storage facilities, despite the short-term earnings dilution, because it is advantageous for us to continue to expand our asset base and benefit from the resulting increased critical mass, with facilities that will improve our portfolio's overall average construction and location quality.

The decision to commence development of any particular self-storage location is based upon several factors with respect to that local market, including our estimate of current and future general economic conditions, demographic conditions, population growth, the likelihood of and cost of obtaining permits, construction costs, as well as the level of demand at our existing self-storage facilities in proximity to the prospective facility. Our level of new development starts has declined significantly in the last few years due to increases in construction costs, increases in competition with retail, condominium, and apartment operators for quality construction sites in urban locations, and more difficult zoning and permitting requirements, which has reduced the number of attractive sites available for development and reduced our development of facilities. It is unclear when, or if, these conditions will improve.

### SELF-STORAGE OPERATIONS - NEWLY CONSOLIDATED FACILITIES

Effective January 1, 2006, as described in Note 2 to our condensed consolidated financial statements, we are including the accounts of three limited partnerships that we had previously accounted for under the equity method of accounting. These facilities are substantially all mature facilities that we have managed and had an interest in for several years. These 16 facilities have an aggregate of 879,000 net rentable square feet. Accordingly, their future operating characteristics and past operating history are similar to those of our Same Store facilities.

65

The following chart sets forth the operations of the Newly Consolidated Facilities (amounts in thousands):

Three Months Ended	Nine Months Ended
-----------------------	----------------------

Edgar Filing: PUBLIC STORAGE INC /CA - Form 10-Q

	September 30, 2006	September 30, 2006
	-----	-----
Rental income.....	\$ 3,686	\$ 10,874
Cost of operations (excluding depreciation).	924	2,644
	-----	-----
Net operating income before depreciation (a)	2,762	8,230
Depreciation.....	(116)	(504)
	-----	-----
Net operating income.....	\$ 2,646	\$ 7,726
	=====	=====
Weighted average square foot occupancy during the period:.....	89.6%	89.1%
Weighted average realized annual rent per occupied square foot for the period:.....	\$ 16.77	\$ 16.47
In place annual rent per occupied square foot at September 30:.....		\$ 18.88

(a) Total net operating income before depreciation, which is a non-GAAP measure, for our commercial property segment is presented in Note 13 to our condensed consolidated financial statements, "Segment Information," which includes a reconciliation of net operating income before depreciation for this segment to our consolidated net income.

COMMERCIAL PROPERTY OPERATIONS: Commercial property operations included in our consolidated financial statements include commercial space owned by the Company and entities consolidated by the Company. We have a much larger interest in commercial properties through our ownership interest in PS Business Parks Inc. and its consolidated operating partnership (PS Business Parks, Inc. and its consolidated operating partnership are hereinafter referred to as "PSB"). Our investment in PSB is accounted for using the equity method of accounting, and accordingly our share of PSB's earnings is reflected as "Equity in earnings of real estate entities," see below.

We acquired 309,000 net rentable square feet in the merger with Shurgard. As a result, at September 30, 2006 total net rentable square feet increased to 1,605,000 from 1,296,000 at June 30, 2006. Our commercial space is principally operated at certain of the self-storage facilities.

The results of our commercial operations are provided in the table below (amounts in thousands):

Commercial Property Operations:  
(excluding discontinued operations)

	Three Months Ended September 30,			Nine Months	
	2006	2005	Change	2006	
	-----	-----	-----	-----	-----
Rental income.....	\$ 3,408	\$ 2,918	\$ 490	\$ 9,413	\$
Cost of operations.....	(1,497)	(1,122)	(375)	(4,080)	
	-----	-----	-----	-----	-----
Net operating income before depreciation (a).....	1,911	1,796	115	5,333	

Edgar Filing: PUBLIC STORAGE INC /CA - Form 10-Q

Depreciation.....	(643)	(562)	(81)	(1,777)	
Operating income.....	\$ 1,268	\$ 1,234	\$ 34	\$ 3,556	\$

(a) Total net operating income before depreciation, which is a non-GAAP measure, for our commercial property segment is presented in Note 13 to our September 30, 2006 condensed consolidated financial statements, "Segment Information," which includes a reconciliation of net operating income before depreciation for this segment to our consolidated net income.

Our commercial property operations consist primarily of facilities that are at a stabilized level of operations, and generally reflect the conditions of the markets in which they operate. We do not expect any significant growth in net operating income from this segment of our business for the remainder of 2006.

66

Containerized Storage Operations: We have closed many of our containerized storage facilities since 2002, and have refined our market and product focus to 12 facilities located in eight densely populated markets with above-average rent and income. The operations with respect to the facilities other than the 12 ongoing facilities are included in "Discontinued Operations" on our income statement. The operations of the 12 remaining facilities are included in PSPUD's continuing operations and are reflected on the table below:

Containerized Storage:  
(excluding discontinued operations)

	Three Months Ended September 30,			Nine Months September	
	2006	2005	Change	2006	2005
	(Amounts in thousands)				
Rental and other income .....	\$ 4,353	\$ 4,480	\$ (127)	\$12,483	\$12,305
Cost of operations:					
Direct operating costs.....	3,135	3,308	(173)	9,234	8,602
Facility lease expense.....	772	368	404	2,202	1,090
Total cost of operations.....	3,907	3,676	231	11,436	9,692
Net operating (loss) income before depreciation (a).....	446	804	(358)	1,047	2,613
Depreciation expense (b).....	(179)	(313)	134	(662)	(2,490)
Operating (loss) income.....	\$ 267	\$ 491	\$ (224)	\$ 385	\$ 123

(a) Total net operating income before depreciation, which is a non-GAAP measure described above, for our containerized storage segment is presented in Note 13 to our September 30, 2006 condensed consolidated financial statements, "Segment Information," which includes a

## Edgar Filing: PUBLIC STORAGE INC /CA - Form 10-Q

reconciliation of net operating income before depreciation for this segment to our consolidated net income.

- (b) Depreciation expense principally relates to the depreciation of containers; however, depreciation expense for the three and nine months ended September 30, 2006 includes \$126,000 and \$504,000, respectively, related to real estate facilities compared to \$262,000 and \$786,000 for the same periods in 2005, respectively.

Rental and other income includes monthly rental charges to customers for storage of the containers, service fees charged for pickup and delivery of containers to customers' homes and businesses and certain non-core services which were eliminated, such as handling and packing customers' goods from city to city. At September 30, 2006, there were approximately 21,065 occupied containers in the continuing facilities.

Direct operating costs principally includes payroll, equipment lease expense, utilities and vehicle expenses (fuel and insurance). Direct operating costs for the three and nine months ended September 30, 2006 also includes approximately \$337,000 and \$960,000 of research and development costs, respectively. Facility lease expense has increased significantly as we have moved the operations from wholly-owned combination facilities to facilities that we lease from third parties.

There can be no assurance as to the level of the containerized storage business's expansion, level of gross rentals, level of move-outs or profitability. We continue to evaluate the business operations, and additional facilities may be closed.

ANCILLARY OPERATIONS: Our Ancillary operations include the operating results of our tenant insurance, truck rental, merchandise, and third-party property management operations. The following table sets forth our ancillary operations:

67

	Three Months Ended September 30,			Nine Months September	
	2006	2005	Change	2006	
	(Amounts in thousands)				
<b>Revenues:</b>					
Tenant reinsurance premiums.....	\$ 9,790	\$ 6,332	\$ 3,458	\$ 24,379	\$
Merchandise sales.....	7,566	6,261	1,305	18,879	
Truck rentals.....	4,106	4,208	(102)	10,535	
Property management.....	644	786	(142)	1,856	
Total revenues.....	22,106	17,587	4,519	55,649	
<b>Cost of operations:</b>					
Tenant reinsurance.....	3,714	3,017	697	9,929	
Merchandise sales.....	6,347	5,096	1,251	16,541	
Truck rentals.....	3,328	3,322	6	9,089	
Property management.....	58	178	(120)	200	
Total cost of operations.....	13,447	11,613	1,834	35,759	

Edgar Filing: PUBLIC STORAGE INC /CA - Form 10-Q

Net operating income:					
Tenant reinsurance.....	6,076	3,315	2,761	14,450	
Merchandise sales.....	1,219	1,165	54	2,338	
Truck rentals.....	778	886	(108)	1,446	
Property management.....	586	608	(22)	1,656	
Total net operating income...	\$ 8,659	\$ 5,974	\$ 2,685	\$ 19,890	\$

Tenant reinsurance operations

PSIC reinsures policies against losses to goods stored by tenants in our self-storage facilities. Revenues are comprised of fees charged to tenants electing such policies. Cost of operations primarily includes claims paid that are not covered by our outside third-party insurers (described below), as well as claims adjusting expenses.

For 2005, we had outside third-party insurance coverage for claims paid exceeding \$500,000 resulting from any individual event, to a limit of \$10,000,000. Effective January 1, 2006, such coverage was revised to cover claims paid exceeding \$1,500,000 resulting from any individual event, to a limit of \$9,000,000.

The future level of tenant reinsurance revenues is largely dependent upon the number of new tenants electing to purchase policies, premiums charged for such insurance and existing tenant retention to continue participating in the insurance program. For the nine months ended September 30, 2006 and 2005, approximately 32.4% and 33.0%, respectively, of our self-storage tenant base had such policies. During 2005 and 2004, we experienced damage caused by hurricanes to several of our facilities in our Florida and New Orleans markets. As a result of such damage, we recorded estimated tenant claim expense during the quarter in which the damage occurred. As time progressed, the tenant claims liabilities were adjusted, either increasing or decreasing the liabilities, based on actual claims history. As a result of these adjustments, we experienced significant volatility in our reported quarterly cost of operations, particularly with respect to 2005.

The future cost of operations will be dependent primarily upon the level of losses incurred, including the level of catastrophic events, such as hurricanes, that occur and affect our properties. The aforementioned increase in the deductible of \$1,500,000 per event could result in higher loss expense in the remainder of 2006, depending upon the number of catastrophic losses that occur.

For the quarter ended September 30, 2006, tenant reinsurance revenues and cost of operations, respectively, included \$745,000 and \$291,000 with respect to the Shurgard facilities we acquired in the United States, and \$784,000 and \$260,000 for the Shurgard facilities in Europe.

68

Merchandise and truck rental operations

Through a taxable REIT subsidiary, all of our self-storage facilities sell locks, boxes, and packing supplies to our tenants as well as the general public. Revenues and cost of operations for these activities are included in the

## Edgar Filing: PUBLIC STORAGE INC /CA - Form 10-Q

table above as "Merchandise Sales." In addition, at selected locations, our subsidiary maintains trucks on site for rent to our self-storage customers and the general public on a short-term basis for local use. In addition, we also act as an agent for a national truck rental company to provide their rental trucks to customers for long-distance use. The revenues and cost of operations for these activities are included in the table above as "Truck rentals."

These activities generally serve as an adjunct to our self-storage operations providing our tenants with goods and services that they need in connection with moving and storing their goods.

The revenues of these activities have remained relatively stable during the periods reflected in the table above. Cost of operations with respect to merchandise sales has increased approximately \$1,251,000, or 24.5% for the three months ended September 30, 2006 as compared to the same period in 2005. This increase has been caused primarily by higher payroll costs, as we have added more retail store managers combined with higher cost of purchasing inventory for sale. The primary factors impacting the levels of operations of these activities are the levels of customer traffic at our self-storage facilities, including the levels of move-ins.

For the quarter ended September 30, 2006, merchandise revenues and cost of operations, respectively, included \$929,000 and \$481,000 with respect to the Shurgard facilities we acquired in the United States, and \$778,000 and \$376,000 for the Shurgard facilities in Europe.

For the quarter ended September 30, 2006, truck revenues and cost of operations, respectively, included \$290,000 and \$234,000 with respect to the Shurgard facilities we acquired in the United States.

### Property management operations -----

We manage 34 self-storage facilities on behalf of third-party owners and 22 self-storage facilities that are owned by the Unconsolidated Entities. Under the supervision of the property owners, we coordinate rental policies, rent collections, marketing activities, the purchase of equipment and supplies, maintenance activities, and the selection and engagement of vendors, suppliers, and independent contractors. We also assist and advise the property owners in establishing policies for the hire, discharge, and supervision of employees for the operation of these facilities.

Property management operations declined in the nine months ended September 30, 2006 as compared to the same period in 2005, due to our consolidation, effective January 1, 2006, of three partnerships owning 16 self-storage facilities that we had previously accounted for under the equity method of accounting. This resulted in the elimination in consolidation of management fee income and cost of operations with respect to these three partnerships for periods after January 1, 2006.

Our operating income from these activities is generally dependent upon the revenues earned at the managed facilities, because our management fee is based upon revenues. Management contracts with the third-party owners can be terminated by either party upon 60 days written notice.

**EQUITY IN EARNINGS OF REAL ESTATE ENTITIES:** In addition to our ownership of equity interests in PSB, we had general and limited partnership interests in eight limited partnerships at September 30, 2006. (PSB and the limited partnerships are collectively referred to as the "Unconsolidated Entities"). Due to our limited ownership interest and limited control of these entities, we do not consolidate the accounts of these entities for financial reporting purposes. We account for such investments using the equity method.

Edgar Filing: PUBLIC STORAGE INC /CA - Form 10-Q

Equity in earnings of real estate entities for the three and nine months ended September 30, 2006 and 2005 consists of our pro-rata share of the Unconsolidated Entities based upon our ownership interest for the period. The following table sets forth the significant components of equity in earnings of real estate entities:

69

	Three Months Ended September 30,		Change	Nine Mont Septem
	2006	2005		2006
	(Amounts in thousands)			
Property operations:				
PSB.....	\$ 18,664	\$ 17,737	\$ 927	\$ 54,775
Acquisition Joint Venture.....	110	75	35	297
Newly consolidated partnerships (1)....	-	1,322	(1,322)	-
Other investments (2).....	763	722	41	2,141
	19,537	19,856	(319)	57,213
Depreciation:				
PSB.....	(9,779)	(8,352)	(1,427)	(28,034)
Acquisition Joint Venture.....	(70)	(68)	(2)	(207)
Newly consolidated partnerships (1)....	-	(216)	216	-
Other investments (2).....	(182)	(186)	4	(510)
	(10,031)	(8,822)	(1,209)	(28,751)
Other: (3)				
PSB (4).....	(6,867)	(1,134)	(5,733)	(19,107)
Newly consolidated partnerships (1)....	-	(31)	31	-
Other investments (2).....	(21)	(16)	(5)	(147)
	(6,888)	(1,181)	(5,707)	(19,254)
Total equity in earnings of real estate entities.....	\$ 2,618	\$ 9,853	\$ (7,235)	\$ 9,208

(1) As described more fully in Note 2 to our financial statements, we commenced consolidating the accounts of three limited partnerships that we had previously accounted for under the equity method of accounting. Accordingly, equity in income with respect to these partnerships ceased effective January 1, 2006.

(2) Amounts primarily reflect equity in earnings recorded for investments that have been held consistently throughout each of the three and nine months ended September 30, 2006 and 2005.

(3) "Other" reflects our share of general and administrative expense, interest expense, interest income, and other non-property;



## Edgar Filing: PUBLIC STORAGE INC /CA - Form 10-Q

non-depreciation related operating results of these entities. The amount of interest expense included in "other" is \$271,000 and \$729,000 for the three and nine months ended September 30, 2006, respectively, as compared to \$131,000 and \$375,000, respectively, for the same periods in 2005.

- (4) "Other" with respect to PSB also includes our pro-rata share of gains on sale of real estate assets, impairment charges relating to pending sales of real estate and the impact of PSB's application of the SEC's clarification of EITF Topic D-42 on redemptions of preferred securities.

Equity in earnings of real estate entities includes our pro rata share of the net impact of gains/losses on sales of assets and impairment charges relating to the impending sale of real estate assets as well as our pro rata share of the impact of the application of EITF Topic D-42 on redemptions of preferred securities recorded by PSB. Our net pro rata share from these items resulted in a net decrease of equity in earnings of \$576,000 and \$282,000 for the three and nine months ended September 30, 2006, respectively. For the three and nine months ended September 30, 2005, our pro rata share of these items resulted in net increases of \$5,458,000 and \$7,033,000, respectively.

The impact of the PSB items discussed above led to a decrease in equity in earnings of real estate entities totaling \$6,034,000 and \$7,315,000, respectively, when comparing the three and nine month periods ended September 30, 2006 to the same periods in 2005. In addition, equity in earnings real estate entities decreased due to our consolidation of three limited partnerships effective January 1, 2006 as described in Note 2 to our condensed consolidated financial statements. As a result of this consolidation, equity in income with respect to these partnerships ceased effective January 1, 2006.

70

Equity in earnings of PSB represents our pro rata share (approximately 44% for the nine months ended September 30, 2006 and 2005) of the earnings of PSB. Throughout 2005 and the nine months ended September 30, 2006, we owned 5,418,273 common shares and 7,305,355 operating partnership units (units which are convertible into common shares on a one-for-one basis) in PSB. At September 30, 2006, PSB owned and operated 18.2 million net rentable square feet of commercial space located in eight states. PSB also manages commercial space owned by the Company and affiliated entities at September 30, 2006 pursuant to property management agreements.

Our future equity income from PSB will be dependent entirely upon PSB's operating results. Our investment in PSB provides us with some diversification into another asset type. We have no plans of disposing of our investment in PSB. PSB's filings and selected financial information can be accessed through the Securities and Exchange Commission, and on its website, [www.psbusinessparks.com](http://www.psbusinessparks.com).

In January 2004, we entered into a joint venture partnership with an institutional investor for the purpose of acquiring up to \$125.0 million of existing self-storage properties in the United States from third parties (the "Acquisition Joint Venture"). The venture is funded entirely with equity consisting of 30% from us and 70% from the institutional investor. As described more fully in Note 2 to our condensed consolidated financial statements for the nine months ended September 30, 2006, our pro-rata share of earnings with respect to two of the facilities acquired directly from third parties by the Acquisition Joint Venture in 2004, at an aggregate cost of \$9,086,000, are reflected in Equity in Earnings in the table above. Our initial investment in the Acquisition Joint Venture with respect to these two facilities was approximately \$2,930,000. Our future equity in earnings with respect to the

## Edgar Filing: PUBLIC STORAGE INC /CA - Form 10-Q

Acquisition Joint Venture will be dependent upon the level of earnings generated by these two properties.

The "Other Investments" are comprised primarily of our equity in earnings from four limited partnerships, for which we held an approximate consistent level of equity interest throughout 2005 and the first nine months of 2006. The Company formed these limited partnerships during the 1980's. We are the general partner in each limited partnership, and manage each of these facilities for a management fee that is included in "Ancillary operations." The limited partners consist of numerous individual investors, including the Company, which throughout the 1990's acquired units of limited partnership interests in these limited partnerships in various transactions.

Our future earnings with respect to the "Other Investments" will be dependent upon the operating results of the 20 self-storage facilities that these entities own. The operating characteristics of these facilities are similar to those of the Company's self-storage facilities, and are subject to the same operational issues as the Same Store Facilities as discussed above. See Note 6 to our condensed consolidated financial statements for the operating results of these entities for the nine months ended September 30, 2006 and 2005.

### OTHER INCOME AND EXPENSE ITEMS

**INTEREST AND OTHER INCOME:** Interest and other income was \$12,651,000 and \$27,773,000 for the three and nine months ended September 30, 2006, respectively, as compared to \$4,717,000 and \$11,004,000, respectively, for the same periods in 2005. This increase is due to earning higher interest rates on invested cash balances combined with significantly higher average cash balances invested in interest-bearing accounts as compared to the same periods in 2005.

**DEPRECIATION AND AMORTIZATION:** Depreciation and amortization expense was \$113,531,000 and \$212,206,000 for the three and nine months ended September 30, 2006, respectively, compared to \$47,896,000 and \$144,074,000 for the same periods in 2005.

71

The increase in depreciation and amortization for the three and nine months ended September 30, 2006, as compared to the same period in 2005 is due primarily to \$50,626,000 in amortization expense recorded during the three months ended September 30, 2006 on the intangible assets for the value of the storage tenants in place which we acquired in the Shurgard merger. These intangible assets were valued in our purchase accounting analysis at \$483,107,000 and are being amortized over a three year useful life. Amortization is expected to be approximately \$94,800,000 in the fourth quarter of 2006, \$69,700,000 in the first quarter of 2007 and approximately \$125,000,000 during the remainder of 2007.

The remainder of the increase in depreciation and amortization for the three and nine months ended September 30, 2006 as compared to the same periods in 2005 is due primarily to assets acquired in the Shurgard merger and to our newly developed and acquired facilities. See Notes 2 and 3 to our unaudited condensed consolidated financial statements for further discussion of the Shurgard merger and the acquisition of tangible and intangible assets.

Also included in depreciation and amortization expense for the nine months ended September 30, 2006 is \$1,651,000 (none for the three months ended September 30, 2006) related to the amortization of intangibles, as compared to \$1,651,000 and \$4,953,000 for the three and nine months ended September 30, 2005, respectively. Amortization ceased as of April 1, 2006, as described more fully in Note 2 to our unaudited condensed consolidated financial statements.

## Edgar Filing: PUBLIC STORAGE INC /CA - Form 10-Q

**GENERAL AND ADMINISTRATIVE:** General and administrative expense was \$36,242,000 and \$49,996,000 for the three and nine months ended September 30, 2006, as compared to \$5,621,000 and \$16,890,000 for the same periods in 2005, representing increases of \$30,621,000 and \$33,106,000, respectively. General and administrative expense principally consists of state income taxes, investor relations expenses and corporate and executive salaries. In addition, general and administrative expenses includes expenses that vary depending on the Company's activity levels in certain areas, such as overhead associated with the acquisition and development of real estate facilities, employee severance and stock-based compensation, and product research and development expenditures.

General and administrative expense for the three months ended September 30, 2006 include costs and expenses totaling \$18,086,000 incurred in connection with the integration of Shurgard and Public Storage, costs for cancelled development projects in the U.S. and Europe totaling \$9,319,000 and contract termination fees of \$2,233,000. We expect to incur an additional \$15 million to \$20 million in additional integration costs in the fourth quarter of 2006.

Restricted stock and stock option expense amounted to approximately \$1,841,000 and \$4,868,000 for the three and nine months ended September 30, 2006, respectively, as compared to \$1,196,000 and \$3,579,000, respectively, for the same periods in 2005.

**INTEREST EXPENSE:** Interest expense was \$9,323,000 and \$12,752,000 for the three and nine months ended September 30, 2006, respectively, compared to \$2,471,000 and \$5,928,000, respectively, for the same periods in 2005. Interest capitalized during the three and nine months ended September 30, 2006 was \$530,000 and \$1,599,000, respectively, as compared to \$710,000 and \$2,054,000, respectively, for the same periods in 2005. The increase in interest expense is primarily due to \$7,154,000 in interest incurred on the debt and other obligations we assumed in the Shurgard merger partially offset by a decrease of \$669,000 in interest expense due to lower balances on our outstanding notes. See also Notes 8 and 9 to our unaudited condensed consolidated financial statements for a schedule of our debt balances, principal repayment requirements, and average interest rates. Based upon the level of debt outstanding at September 30, 2006, and the interest rates in effect at that time on the various variable rate components of our debt and the fixed rates of interest, interest expense would be approximately \$16,985,000 in the fourth quarter of 2006 with respect to the debt we assumed from Shurgard.

72

During the three months ended September 30, 2006, we paid \$881,000 related to interest rate and currency swaps acquired in the Shurgard merger. We have included this \$881,000 as a reduction of income on derivatives, net on our unaudited condensed consolidated statement of operations for the three and nine months ended September 30, 2006. See discussion below under Income from Derivatives, Net.

**FOREIGN EXCHANGE LOSS:** We had foreign exchange losses of \$172,000 for the three and nine months ended September 30, 2006.

**INCOME FROM DERIVATIVES, NET:** This represents a gain as recognized for the changes in the fair market values of those derivative financial instruments that do not qualify for hedge accounting treatment under SFAS No. 133 offset by interest expense incurred on certain derivative instruments. The gain of \$32,000 for the three and nine months ended September 30, 2006 is primarily the net effect of gains of \$913,000 in changes in value of our interest rate swaps and currency forward contracts on the euro that do not qualify for hedge accounting, partially offset by payments of \$881,000 incurred in connection with certain

## Edgar Filing: PUBLIC STORAGE INC /CA - Form 10-Q

interest rate swaps and foreign currency exchange derivatives acquired in the Shurgard merger as described under Note 3 to our condensed consolidated financial statements.

MINORITY INTEREST IN INCOME: Minority interest in income represents the income allocable to equity interests in Consolidated Entities, which are not owned by the Company. The following table summarizes minority interest in income for the three and nine months ended September 30, 2006 and 2005:

73

	Three Months Ended September 30,			2005
	2006	2005	Change	
				(Amounts in thousands)
Preferred partnership interests:				
Ongoing distributions (a).....	\$ 5,403	\$ 3,591	\$ 1,812	\$ 13,000
Special Distribution and EITF Topic D-42 (b)	-	-	-	
Acquired minority interests (c).....	-	1,309	(1,309)	
Newly consolidated partnerships (d).....	1,468	-	1,468	3,000
Convertible Partnership Units (e).....	120	148	(28)	
Shurgard U.S. minority interests (f)	191	-	191	
Shurgard U.S. European minority interests (g).	(1,279)	-	(1,279)	(1,000)
Other minority interests (h).....	2,687	2,195	492	7,000
<hr style="border-top: 1px dashed black;"/>				
Total minority interests in income.....	\$ 8,590	\$ 7,243	\$ 1,347	\$ 24,000
<hr style="border-top: 3px double black;"/>				

(a) The increase in ongoing distributions is due to the issuance of additional preferred partnership units offset by the redemption of \$40,000,000 of our 9.5% Series N Preferred Units on March 17, 2005 and \$45,000,000 of our 9.125% Series O Preferred units on March 29, 2005.

(b) In accordance with the Securities and Exchange Commission's clarification of EITF Topic D-42, original issuance costs with respect to our first quarter of 2005 redemption of preferred units included in minority interest in income for the three months ended March 31, 2005 totaling \$874,000.

(c) These amounts reflect income allocated to minority interests that the Company acquired in 2005 and are no longer outstanding at September 30, 2006.

(d) These amounts reflect income allocated to minority interests for three entities that we commenced consolidating the accounts for effective January 1, 2006 (see Note 2 to our condensed consolidated financial statements). Included in minority interest in income for the three and nine months ended September 30, 2006 was \$32,000 and \$98,000, respectively, in depreciation expense.

(e) These amounts reflect the minority interests represented by the Convertible Partnership Units (see Note 11 to our condensed consolidated financial statements).

Edgar Filing: PUBLIC STORAGE INC /CA - Form 10-Q

- (f) These amounts reflect income allocated to minority interests in entities we acquired in the merger with Shurgard, and include \$55,000 in depreciation in the three and nine months ended September 30, 2006.
- (g) These amounts reflect income allocated to minority interests from entities we acquired in the merger with Shurgard. These interests include the 80% partner's interests in the European joint ventures, First Shurgard and Second Shurgard, as well as those in domestic joint ventures. Included in minority interest in income is \$742,000 for the three and nine months ended September 30, 2006 in depreciation, and \$1,829,000 in interest expense.
- (h) These amounts reflect income allocated to minority interests that were outstanding consistently throughout the nine months ended September 30, 2006 and 2005. Included in minority interest in income is \$109,000 and \$401,000 in depreciation expense for the three and nine months ended September 30, 2006, respectively, as compared to \$57,000 and \$536,000 for the same periods in 2005.

Other minority interests reflect income allocated to minority interests that have maintained a consistent level of interest throughout 2005 and the nine months ended September 30, 2006, comprised of investments in the Consolidated Entities described in Note 9 to our condensed consolidated financial statements. The level of income allocated to these interests in the future is dependent upon the operating results of the storage facilities that these entities own, as well as any minority interests that the Company acquires in the future.

On May 9, 2006, one of our Consolidated Entities issued \$100,000,000 of its 7.25% Series J Preferred Partnership Units. Accordingly, ongoing distributions with respect to preferred partnership interest are expected to increase.

74

Discontinued Operations: As described more fully in Note 4 to our condensed consolidated financial statements, during 2002, 2003 and 2004, we implemented a business plan which included the closure of 43 of 55 containerized storage facilities that were open at December 31, 2001. The 43 facilities are hereinafter referred to as the "Closed Facilities."

During July 2005, in an eminent domain proceeding, one of our self-storage facilities located in the Portland, Oregon market was condemned by local governmental authorities. Additionally, in July 2006, one of our self-storage facilities in our Seattle, Washington market was condemned by local governmental authorities in an eminent domain proceeding. Collectively, these Portland and Seattle facilities are referred to as "the Eminent Domain Facilities".

The following table summarizes the historical operations of the Eminent Domain Facilities and the Closed Facilities:

DISCONTINUED OPERATIONS:

-----

Three Months Ended September 30,			Nine Months September
2006	2005	Change	2006
-----	-----	-----	-----

Edgar Filing: PUBLIC STORAGE INC /CA - Form 10-Q

(Amounts in thousands)

Rental income.....	\$ 1	\$ 281	\$ (280)	\$ 193
Cost of operations.....	(21)	(80)	59	(109)
Depreciation and amortization .....	(9)	(41)	32	(50)
	-----	-----	-----	-----
Income before other items.....	(29)	160	(189)	34
Other items:				
Net gain on disposition of assets	2,370	5,180	(2,810)	2,370
	-----	-----	-----	-----
Net discontinued operations.....	\$ 2,341	\$ 5,340	\$ (2,999)	\$ 2,404
	=====	=====	=====	=====

LIQUIDITY AND CAPITAL RESOURCES

-----

We believe that our internally generated net cash provided by operating activities will continue to be sufficient to enable us to meet our operating expenses, capital improvements, debt service requirements and distributions to shareholders for the foreseeable future. In addition, at September 30, 2006, cash on hand totaled \$124,119,000 and we had no outstanding borrowings under our \$200,000,000 bank line of credit. We anticipate that a significant portion of the cash on-hand will be utilized in connection with the proposed merger with Shurgard, see below.

Operating as a real estate investment trust ("REIT"), our ability to retain cash flow for reinvestment is restricted. In order for us to maintain our REIT status, a substantial portion of our operating cash flow must be distributed to our shareholders (see "Requirement to Pay Distributions" below). However, despite the significant distribution requirements, we have been able to retain a significant amount of our operating cash flow. The following table summarizes our ability to fund distributions to the minority interest, capital improvements to maintain our facilities, and distributions to our shareholders through the use of cash provided by operating activities. The remaining cash flow generated is available to make both principal payments on debt and for reinvestment.

75

	Nine Months Ended Septe	
	2006	20
	(Amounts in thousand	
	-----	-----
Net cash provided by operating activities.....	\$ 582,152	\$
Distributions to minority interest (Preferred Units).....	(13,652)	
Distributions to minority interest (common equity).....	(11,037)	
	-----	-----
Cash from operations allocable to our shareholders.....	557,463	
Capital improvements to maintain our facilities.....	(44,366)	
	-----	-----
Remaining operating cash flow available for distributions to our		

Edgar Filing: PUBLIC STORAGE INC /CA - Form 10-Q

shareholders.....	513,097	
Distributions paid:		
Preferred stock dividends.....	(159,256)	(
Equity Stock, Series A dividends.....	(16,068)	(
Distributions to Common shareholders.....	(213,281)	(
	-----	-----
Cash available for principal payments on debt and reinvestment..	\$ 124,492	\$
	=====	=====

Our financial profile is characterized by a low level of debt-to-total capitalization and a conservative dividend payout ratio with respect to the common stock. We expect to fund our growth strategies with cash on hand at September 30, 2006, internally generated retained cash flows and proceeds from issuing equity securities. In general, our current strategy is to continue to finance our growth with permanent capital; either common or preferred equity. We have in the past used our \$200,000,000 line of credit as temporary "bridge" financing and repaid those amounts with internally generated cash flows and proceeds from the placement of permanent capital.

Over the past three years, we have funded substantially all of our acquisitions with permanent capital (both common and preferred securities). We have elected to use preferred securities as a form of leverage despite the fact that the dividend rates of our preferred securities exceed the prevailing market interest rates on conventional debt. We have chosen this method of financing for the following reasons: (i) under the REIT structure, a significant amount of operating cash flow needs to be distributed to our shareholders, making it difficult to repay debt with operating cash flow alone, (ii) our perpetual preferred stock has no sinking fund requirement or maturity date and does not require redemption, all of which eliminate any future refinancing risks, (iii) after the end of a non-call period, we have the option to redeem the preferred stock at any time, which enabled us to effectively refinance higher coupon preferred stock with new preferred stock at lower rates, (iv) preferred stock does not contain onerous covenants, thus allowing us to maintain significant financial flexibility, and (v) dividends on the preferred stock can be applied to our REIT distribution requirements.

Our credit ratings on each of our series of Cumulative Preferred Stock are "Baa2" by Moody's and "BBB+" by Standard & Poor's.

Our portfolio of real estate facilities remains substantially unencumbered. At September 30, 2006, we have domestic mortgage debt outstanding of \$274,891,000, which encumbers 106 facilities with an aggregate net book value of approximately \$1,063,558,000 and European mortgage debt and capital leases outstanding of \$675,134,000, which encumbers 154 facilities with an aggregate net book value of approximately \$1,148,841,000. At September 30, 2006, we also have Debt to Joint Venture Partner amounting to \$37,214,000 with respect to ten real estate facilities with an aggregate net book value of approximately \$47,951,000. The remaining debt on our balance sheet totaling \$476,508,000 does not specifically encumber real estate facilities.

For the nine months ended September 30, 2006, our cash available for principal payments on debt and reinvestment declined from \$148,498,000 to \$124,492,000 due to the impact of merger integration expenses approximately \$20.1 million for the nine months ended September 30, 2006, as well as the impact of paying an entire quarter's distribution on the 39.1 million shares issued to former Shurgard shareholders while the operating cash flows were reflected only from August 22, 2006 through September 30, 2006.

## Edgar Filing: PUBLIC STORAGE INC /CA - Form 10-Q

**Recent Issuance and Redemption of Preferred Securities:** One of our financing objectives over the past several years has been to reduce our average cost of capital with respect to our preferred securities. Accordingly, we have redeemed higher rate preferred securities outstanding and have financed the redemption with cash on-hand or from the proceeds from the issuance of lower rate preferred securities.

On September 28, 2006, we redeemed our 8.000% Series R Preferred Stock for \$510 million, plus accrued and unpaid dividends. The Series R was called for redemption in August 2006. On September 26, 2006, we called for redemption our 7.875% Series S Preferred Stock for \$143.75 million, plus accrued and unpaid dividends. The Series S was redeemed on October 31, 2006. As a result of these redemptions, there was an additional allocation to the preferred shareholders during the three months ended September 30, 2006 of approximately \$21,643,000 (\$0.15 per common share, based upon the weighted average diluted shares during the three months ended September 30, 2006) from the application of EITF Topic D-42. We believe that our size and financial flexibility enables us to access capital when appropriate.

During the ten months ended October 31, 2006, we have received net proceeds of approximately \$1.3 billion from the issuance of cumulative Preferred Stock and \$100 million of our preferred partnership units. We used approximately \$826.3 million of these net proceeds in order to redeem higher-coupon preferred securities.

**REQUIREMENT TO PAY DISTRIBUTIONS:** We estimate the distribution requirement with respect to our Preferred Stock outstanding at September 30, 2006 to be approximately \$203.7 million per year. We estimate that the annual distribution requirement with respect to the preferred partnership units outstanding at September 30, 2006, to be approximately \$21.6 million per year.

During each of the nine months ended September 30, 2006 and 2005, we paid cash dividends totaling \$16,068,000 and \$16,087,000, respectively, to the holders of our Equity Stock, Series A. With respect to the depositary shares of Equity Stock, Series A, we have no obligation to pay distributions if no distributions are paid to the common shareholders. To the extent that we do pay common distributions in any year, the holders of the depositary shares receive annual distributions equal to the lesser of (i) five times the per share dividend on the common stock or (ii) \$2.45. The depositary shares are non-cumulative, and have no preference over our common stock either as to dividends or in liquidation. With respect to the Equity Stock, Series A outstanding at September 30, 2006, we estimate the total regular distribution for the fourth quarter of 2006 to be approximately \$5.4 million.

During the nine months ended September 30, 2006, we paid dividends totaling \$213,281,000 (\$1.50 per common share) to the holders of our common stock. Based upon shares outstanding at November 2, 2006 and a quarterly distribution of \$0.50 per share, which was declared by the Board of Directors on November 2, 2006 and payable on December 28, 2006, to shareholders of record as of December 15, 2006, we estimate a dividend payment with respect to our common stock of approximately \$84.5 million for the fourth quarter of 2006.

**CAPITAL IMPROVEMENT REQUIREMENTS:** For the fourth quarter of 2006, we expect to spend approximately \$25 million for capital improvements, excluding signage and other improvements to the Shurgard portfolio. During the nine months ended September 30, 2006, we incurred capital improvements of approximately \$44,366,000. Capital improvements include major repairs or replacements to the facilities that maintain the facilities' existing operating condition and visual appeal. Capital improvements do not include costs relating to the development or expansion of facilities, or expenditures associated with improving the visual and structural appeal of our existing self-storage facilities. We also expect to



## Edgar Filing: PUBLIC STORAGE INC /CA - Form 10-Q

incur approximately \$20 million of capital expenditures to install Public Storage signage on the Shurgard facilities in the United States.

**DEBT SERVICE REQUIREMENTS:** We do not believe we have any significant refinancing risks with respect to our debt, all but \$12,332,000 of which is fixed rate. At September 30, 2006, we have total outstanding debt of approximately \$1,463,747,000. See Notes 8 and 9 to our condensed consolidated financial statements for approximate principal maturities of such borrowings.

77

We anticipate that our retained operating cash flow will continue to be sufficient to enable us to make scheduled principal payments. It is our current intention to fully amortize our domestic debt totaling \$788,613,000 as opposed to refinance debt maturities with additional debt. Our European debt inclusive of capital leases totals \$675,134,000 at September 30, 2006; we expect to refinance approximately \$400 million of this debt in early 2007.

**ACQUISITION AND DEVELOPMENT OF REAL ESTATE FACILITIES:** During 2006, we will continue to seek to acquire additional self-storage facilities from third parties; however, it is difficult to estimate the amount of third party acquisitions we will undertake.

At September 30, 2006, we have a development "pipeline" of 49 projects in the U.S. consisting of self-storage facilities, conversion of space at facilities that was previously used for containerized storage and expansions to existing self-storage facilities. At September 30, 2006, we have acquired the land for all of these projects.

The development and fill-up of these storage facilities is subject to significant contingencies such as obtaining appropriate governmental approvals. We estimate that the amount remaining to be spent to complete development to be approximately \$161.5 million and will be incurred over the next 24 months. The following table sets forth certain information with respect to our development pipeline.

**DEVELOPMENT PIPELINE SUMMARY - U.S.**  
as of September 30, 2006

	Number of projects	Net rentable sq. ft.	Total estimated development costs	Costs in throug 09/3
(Amounts in thousands, except n				
<b>Under construction:</b>				
PUD conversions	2	152	\$ 6,175	\$
Expand/repackage existing self-storage facilities	8	315	33,984	
Expand/repackage existing Shurgard self-storage facilities	15	614	62,773	5
	25	1,081	102,932	6
<b>In development, land acquired:</b>				
PUD conversions	3	276	12,708	
Expand/repackage existing self-storage				

Edgar Filing: PUBLIC STORAGE INC /CA - Form 10-Q

facilities	21	1,393	122,475	1
	-----	-----	-----	-----
	24	1,669	135,183	1
	-----	-----	-----	-----
Total Development Pipeline	49	2,750	\$ 238,115	\$ 7
	=====	=====	=====	=====

At September 30, 2006, we have a development "pipeline" of 11 projects in Europe consisting of self-storage facilities. At September 30, 2006, we have acquired the land for all of these projects.

The development and fill-up of these storage facilities is subject to significant contingencies such as obtaining appropriate governmental approvals. We estimate that the amount remaining to be spent to complete development to be approximately \$35.0 million and will be incurred over the next 24 months. Substantially all of these future costs will be funded by the Shurgard European Joint Ventures, in which we have a 20% interest, and which have a substantial degree of funding by debt. The following table sets forth certain information with respect to our development pipeline.

78

DEVELOPMENT PIPELINE SUMMARY - EUROPE  
as of September 30, 2006

	Number of projects	Net rentable sq. ft.	Total estimated development costs	Costs in thro 09/3
(Amounts in thousands, except n				
Under construction:				
Self-storage facilities	9	452	\$ 71,628	\$ 4
In development, land acquired:				
Self-storage facilities	2	89	17,839	
	-----	-----	-----	-----
Total Development Pipeline	11	541	\$ 89,467	\$ 5
	=====	=====	=====	=====

CONTRACTUAL OBLIGATIONS

Our significant contractual obligations at September 30, 2006 and their impact on our cash flows and liquidity are summarized below for the years ending December 31 (amounts in thousands):

	Total	2006	2007	2008	2009
-----					
Long-term debt:					
Public Storage (1) .....	\$ 132,756	\$ 2,613	\$ 20,869	\$ 9,596	\$ 9,
Shurgard U.S. (2).....	830,585	10,329	95,221	58,973	39,
Shurgard Europe (2).....	698,144	1,607	7,829	162,138	99,

Edgar Filing: PUBLIC STORAGE INC /CA - Form 10-Q

Capital leases (3).....	36,423	251	672	685	
Operating leases:					
Public Storage (4).....	66,663	2,593	10,737	7,466	5,
Shurgard U.S. (5).....	62,882	1,498	5,021	3,680	3,
Shurgard Europe (5).....	140,562	1,466	5,255	5,217	5,
Construction commitments:					
Public Storage (6).....	26,404	14,145	12,259	-	
Shurgard U.S. (7).....	12,583	2,601	9,982	-	
Shurgard Europe (7).....	24,133	23,952	83	98	
	=====	=====	=====	=====	=====
Total.....	\$ 2,031,135	\$ 61,055	\$ 167,928	\$ 247,853	\$ 162,
	=====	=====	=====	=====	=====

- (1) Amounts include interest payments on our notes payable based on their contractual terms. See Note 8 to our condensed consolidated financial statements for additional information on our notes payable. Debt to Joint Venture Partner is not reflected since we have not exercised our option to acquire our partner's interest.
- (2) Amounts include interest payments on our notes payable based on their contractual terms that we assumed in the merger with Shurgard. See Note 8 to our condensed consolidated financial statements for additional information on our notes payable.
- (3) This line item reflects amounts due on five European properties with commitments extending to April 2052 that we assumed in the merger with Shurgard.
- (4) We lease trucks, land, equipment and office space under various operating leases. Certain leases are cancelable with substantial penalties.
- (5) Amounts include leases for land, equipment and office space under various operating lease that we assumed in the merger with Shurgard. Certain leases are cancelable with substantial penalties.

79

- (6) Includes obligations for facilities currently under construction at September 30, 2006 as described above under "Acquisition and Development of Real Estate Facilities."
- (7) Includes obligations for facilities currently under construction at September 30, 2006 that we assumed in the merger with Shurgard as described above under "Acquisition and Development of Real Estate Facilities."

In January 2004, we entered into a joint venture partnership with an institutional investor for the purpose of acquiring up to \$125,000,000 of existing self-storage properties in the United States from third parties (the "Acquisition Joint Venture"). As described more fully in Note 2 to our September 30, 2006 condensed consolidated financial statements, our partner's equity contributions with respect to certain transactions are classified as debt under the caption "Debt to Joint Venture Partner" in our condensed consolidated balance sheets. At September 30, 2006, our Debt to Joint Venture Partner was \$37,214,000. For a six-month period beginning 54 months after formation, we have the right to acquire our partner's interest based upon the market value of the properties. If we do not exercise our option, our partner can elect to purchase

## Edgar Filing: PUBLIC STORAGE INC /CA - Form 10-Q

our interest in the properties during a six-month period commencing upon expiration of our six-month option period. If our partner fails to exercise its option, the Acquisition Joint Venture will be liquidated and the proceeds will be distributed to the partners according to the joint venture agreement. We have not included our Debt to Joint Venture Partner as a contractual obligation in the table above, since we only have the right, rather than a contractual obligation, to acquire our partner's interest.

### OFF-BALANCE SHEET ARRANGEMENTS

At September 30, 2006, we had no off-balance sheet arrangements as defined under Regulation S-K 303(a)(4) and the instructions thereto.

### ITEM 3. QUALITATIVE AND QUANTITATIVE DISCLOSURES ABOUT MARKET RISK

-----

To limit our exposure to market risk, we principally finance our operations and growth with permanent equity capital, consisting of either common or preferred stock. At September 30, 2006, our debt as a percentage of total shareholders' equity (based on book values) was 19.1%.

Our preferred stock is not redeemable at the option of the holders. Except under certain conditions relating to the Company's qualification as a REIT, the Preferred Stock is not redeemable by the Company prior to the following dates: Series T - January 18, 2007, Series U - February 19, 2007, Series V - September 30, 2007, Series W - October 6, 2008, Series X - November 13, 2008, Series Y - January 2, 2009, Series Z - March 5, 2009, Series A - March 31, 2009, Series B - June 30, 2009, Series C - September 13, 2009, Series D - February 28, 2010, Series E - April 27, 2010, Series F - August 23, 2010, Series G - December 12, 2010, Series H - January 19, 2011, Series I - May 3, 2011, Series K - August 8, 2011 and Series L - October 20, 2011. On or after the respective dates, each of the series of Preferred Stock will be redeemable at the option of the Company, in whole or in part, at \$25 per depositary share (or share in the case of the Series Y), plus accrued and unpaid dividends through the redemption date.

Our market risk sensitive instruments include notes payable, which totaled \$1,426,533,000 at September 30, 2006. The table below summarizes the annual debt maturities and weighted-average interest rates on our outstanding debt, excluding the debt acquired in the merger with Shurgard, at the end of each year (dollar amounts in thousands):

	2006	2007	2008	2009	2010	Thereafter
	-----	-----	-----	-----	-----	-----
Fixed rate debt (a)...	\$ 1,186	\$ 16,098	\$ 5,155	\$ 5,358	\$ 5,404	\$70,691

(a) Average interest rate of 5.25%.

We are exposed to changes in interest rates primarily from the floating rate debt arrangements we acquired in the merger with Shurgard.

We have foreign currency exposures related to our investment in the construction, acquisition, and operation of storage centers in countries outside the U.S. to the extent such activities are financed with financial instruments

## Edgar Filing: PUBLIC STORAGE INC /CA - Form 10-Q

or equity denominated in non-functional currencies. Since all foreign debt is denominated in the corresponding functional currency, our currency exposure is limited to our equity investment in those countries. Countries in which Shurgard had exposure to foreign currency fluctuations include Belgium, France, the Netherlands, Sweden, Denmark, Germany and the United Kingdom.

The table below summarizes annual debt maturities and weighted-average interest rates on outstanding debt that we acquired in the merger with Shurgard at the end of each year (based on relevant LIBOR 4.90% and a EURIBOR of 3.272% at September 30, 2006 and a forward yield curve for following years) and fair values required to evaluate our expected cash-flows under debt agreements and our sensitivity to interest rate changes at September 30, 2006 (dollar amounts in thousands).

	2006	2007	2008	2009	2010	Thereafter
Fixed rate debt (1)....	\$ 5,418	\$ 59,880	\$ 25,898	\$ 7,402	\$ 15,939	\$ 532,854
Average interest rate..	6.71%	6.61%	6.60%	6.60%	6.61%	5.88%
Variable rate EURIBOR debt (2).....	\$ 1,522	\$ 7,421	\$153,685	\$ 93,873	\$ -	\$ 412,280
Average interest rate..	4.50%	4.86%	4.75%	4.23%		4.32%
Interest rate swaps						
Swap on EURIBOR.....	\$ -	\$ -	\$ (418)	\$ (213)	\$ -	\$ (703)

(1) The fair value of our fixed rate debt decreased by \$24 million, from \$649 million at December 31, 2005, due primarily to an increase in market interest rates.

(2) First Shurgard and Second Shurgard have senior credit agreements denominated in euros to borrow, in aggregate, up to EUR 271.1 million (\$343.9 million as of September 30, 2006). As of September 30, 2006, the available amount under those credit facilities was in aggregate EUR 68.9 million (\$87.4 million).

At September 30, 2006, through our merger with Shurgard, we were party to pay-fixed, receive-variable interest rate swaps. The notional amounts, the weighted-average pay rates and the terms of these agreements are summarized as follows:

	2006	2007	2008	2009	2010	T
Notional amounts (in millions).	\$ 702.1	\$ 719.4	\$ 628.3	\$ 500.2	\$ 412.3	
Weighted average interest rate.	4.97%	4.99%	4.83%	4.54%	4.23%	

Based on our outstanding variable-rate EURIBOR debt and interest rate swaps at September 30, 2006, a hypothetical increase in the interest rates of 100 basis points would cause the value of our derivative financial instruments to increase by EUR 20 million. Conversely, a hypothetical decrease in the interest rates of 100 basis points would cause the value of our derivative financial instruments to decrease by EUR 20 million.

## ITEM 4. CONTROLS AND PROCEDURES

The Company maintains disclosure controls and procedures that are designed to ensure that information required to be disclosed in reports the Company files and submits under the Exchange Act, is recorded, processed, summarized and reported within the time periods specified in accordance with SEC guidelines and that such information is communicated to the Company's management, including its Chief Executive Officer and Chief Financial Officer, to allow timely decisions regarding required disclosure based on the definition of "disclosure controls and procedures" in Rules 13a-15(e) of the Exchange Act. In designing and evaluating the disclosure controls and procedures, management recognized that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives and management necessarily was required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures in reaching that level of reasonable assurance. Also, the Company has investments in certain unconsolidated entities. As the Company does not control or manage these entities, its disclosure controls and procedures with respect to such entities are substantially more limited than those it maintains with respect to its consolidated subsidiaries.

As of the end of the fiscal quarter covered by this report, the Company carried out an evaluation, under the supervision and with the participation of the Company's management, including the Company's Chief Executive Officer and the Company's Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures (as such term is defined in Rules 13a - 15(e) and 15d - 15(e) under the Securities Act of 1934 as amended) as of the end of the period covered by this report. Based upon this evaluation, the Company's Chief Executive Officer and Chief Financial Officer concluded that, as of the end of such period, the Company's disclosure controls and procedures were effective.

There have not been any changes in our internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the fiscal quarter to which this report relates that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

## PART II. OTHER INFORMATION

## ITEM 1. LEGAL PROCEEDINGS

The information set forth under the heading "Legal Matters" in Note 16 to the Consolidated Financial Statements in this Form 10-Q is incorporated by reference in this Item 1.

## ITEM 1A. RISK FACTORS

In addition to the other information in our Form 10-Q and our Form 10-K for the year ended December 31, 2005, you should consider the following factors in evaluating the Company:

WE ARE SUBJECT TO ADDITIONAL RISKS AS A RESULT OF THE SHURGARD MERGER.

In addition to the general risks related to real estate described below

## Edgar Filing: PUBLIC STORAGE INC /CA - Form 10-Q

which may also adversely impact Shurgard's operations, we are also subject to the following risks in connection with the Shurgard merger and integrating Shurgard into our operations, including without limitation the following:

- o difficulties in the integration of operations, technologies and personnel of Shurgard;
- o inability to realize or delays in realizing expected synergies and results;
- o unanticipated operating costs;
- o diversion of our management's attention away from other business concerns;
- o exposure to any undisclosed or unknown potential liabilities of Shurgard;
- o risks related to real estate markets in the United States and in Europe which are new markets for us or in which our operations will be more concentrated as a result of the merger;
- o potential underinsured losses on Shurgard properties; and
- o risk of failure to mitigate any weaknesses in internal control at the operations we acquired from Shurgard to the extent that it affects our internal controls.

We have never undertaken to integrate a company as large as Shurgard or one with overseas operations. The success of the merger will depend, in part, on our ability to realize the anticipated cost savings from combining the businesses of Public Storage and Shurgard. However, to realize the anticipated benefits from the merger, we must successfully combine the businesses of Public Storage and Shurgard in a manner that permits those cost savings to be realized. If we are not able to successfully achieve these objectives, the anticipated benefits of the merger may not be realized fully or at all or may take longer or cost more to realize than expected. It is possible that the integration process could result in the loss of valuable employees, a decline in occupancy and/or rental rates, the disruption of each company's ongoing businesses or inconsistencies in standards, controls, procedures, practices, policies and compensation arrangements that adversely affect our ability to maintain relationships with tenants and employees or to achieve the anticipated benefits of the merger. Further, the size of the transaction may make integration of Public Storage and Shurgard difficult, expensive and disruptive, adversely affecting the combined company's revenues and earnings, and implementation of merger integration efforts may divert management's attention from other strategic priorities. In addition, the merger was structured so that it should have been a taxable transaction for U.S. Federal income tax purposes. As a result, the combined company should have the benefit of a step-up in tax basis in Shurgard's assets. It is possible that the IRS may challenge the step-up in basis. If such challenge were sustained, we would not achieve this benefit, which would reduce our depreciation deductions and our ability to retain cash flow.

We also acquired Shurgard's international operations in Europe, which consist principally of facilities that have been completed in the last few years and are in various stages of fill-up. Shurgard's international operations have not been profitable, and there is no assurance they will ultimately be profitable. Also, Shurgard had a number of non-stabilized properties and construction activity, and delays in construction and fill-up could result in additional costs. We have no experience in European operations, which may adversely impact our ability to operate profitably in Europe. In addition, these

## Edgar Filing: PUBLIC STORAGE INC /CA - Form 10-Q

operations have specific inherent risks, including without limitation the following:

83

- o currency risks, including currency fluctuations and risks related to foreign currency hedging activities;
- o unexpected changes in legislative and regulatory requirements;
- o potentially adverse tax burdens;
- o burdens of complying with different permitting standards, environmental and labor laws and a wide variety of foreign laws;
- o obstacles to the repatriation of earnings and cash;
- o regional, national and local political uncertainty;
- o economic slowdown and/or downturn in foreign markets;
- o difficulties in staffing and managing international operations;
- o reduced protection for intellectual property in some countries; and
- o inability to effectively control less than wholly owned partnerships and joint ventures.

Shurgard also held many of its properties through interests in joint ventures that we acquired and which have additional risks, including risks related to the financial strength, common business goals and strategies and cooperation of the venture partner, as well as the inability to take some actions that may require approval by the venture partner. In addition, Shurgard held substantially all of its real estate investments in Europe indirectly through partnerships and joint venture arrangements. If we are unable to effectively control these indirect investments, there is a risk that our ownership of the joint ventures could cause us to lose our REIT status. These investments also carry the risks that we may not control the legal entity that has title to the real estate, that the enterprise in which we invested may have liabilities that weren't disclosed at the time of the investment, and the risk that these investments may not be easily sold or readily accepted as collateral by our lenders.

As a share of total operations, particularly in Europe, Shurgard had more recently developed properties whose occupancies have not stabilized and had more construction activity than Public Storage, which increase costs. Delays in construction and fill-up could result in additional cost.

Some of the facilities we acquired in the Shurgard merger will be subject to property tax reappraisal that could increase property tax expense and adversely affect our profitability. Up to 17% of the domestic properties we acquired in the merger are located in jurisdictions that may provide for property tax reappraisal upon a change of ownership and so may face such a reassessment. We are not currently able to quantify the possible increases in property tax expense.

We have assumed based on public filings that Shurgard qualified as a real estate investment trust for United States federal income tax purposes, referred to hereinafter as a REIT and that we would be able to continue to qualify as a REIT following the Shurgard merger. However, if Shurgard failed to qualify as a REIT, we generally would have succeeded to or incurred significant



## Edgar Filing: PUBLIC STORAGE INC /CA - Form 10-Q

tax liabilities (including the significant tax liability that would have resulted from the deemed sale of assets by Shurgard pursuant to the merger) and we could possibly lose our REIT status should disqualifying activities continue after the Shurgard merger.

We are also subject to additional financing risks as a result of the Shurgard merger. Shurgard had a significantly greater level of debt than we did, with more fixed and floating rate debt as well as derivative instruments, that we assumed as a result of the merger. At September 30, 2006, our debt, of \$1,463,747,000 was 13.5% of our total assets as compared to our pre-merger indebtedness at June 30, 2006 of \$141 million, which was 2.3% of our assets. The larger indebtedness increases our interest expense, exposes us to the risk of increases in interest rates, and subjects us to greater refinancing risks. We may look to obtain a larger line of credit, bridge financing or other indebtedness, or issue additional preferred or common equity to provide liquidity as Shurgard's borrowings come due.

84

The Shurgard debt agreements we assumed also have covenants that could limit our activities. Failure to comply with such covenants could cause a default under the applicable debt agreement, which could allow the lenders or other debt holders to declare all borrowings outstanding to be due and payable.

PUBLIC STORAGE SHAREHOLDERS INCURRED IMMEDIATE DILUTION FOLLOWING COMPLETION OF THE SHURGARD MERGER.

Public Storage shareholders incurred immediate dilution in connection with the merger. During 2005, Public Storage shareholders would have incurred a loss of \$0.45 per share (diluted) on a pro forma basis compared to earnings of \$1.93 per share (diluted) on a historical basis primarily as a result of an increase in depreciation and amortization expense. No adjustments have been made to the pro forma financial information to reflect certain expected self-storage operating cost savings or increases in property taxes resulting from the merger because they have not been quantified.

THE HUGHES FAMILY COULD CONTROL US AND TAKE ACTIONS ADVERSE TO OTHER SHAREHOLDERS.

At September 30, 2006, B. Wayne Hughes, Chairman of the Board and his family (the "Hughes family") owned approximately 26.7% of our aggregate outstanding shares of common stock. Consequently, the Hughes family could control matters submitted to a vote of our shareholders, including electing directors, amending our organizational documents, dissolving and approving other extraordinary transactions, such as a takeover attempt, even though such actions may not be favorable to the other common shareholders.

PROVISIONS IN OUR ORGANIZATIONAL DOCUMENTS MAY PREVENT CHANGES IN CONTROL.

Restrictions in our organizational documents may further limit changes in control. Unless our Board of Directors waives these limitations, no shareholder may own more than (1) 2.0% of our outstanding shares of our common stock or (2) 9.9% of the outstanding shares of each class or series of our preferred or equity stock. Our organizational documents in effect provide, however, that the Hughes family may continue to own the shares of our common stock held by them at the time of the 1995 reorganization. Our Board has authorized the Hughes family to acquire additional shares of our common stock to maintain their pre-merger holding percentage. These limitations are designed, to the extent possible, to avoid a concentration of ownership that might jeopardize our ability to qualify as a real estate investment trust or REIT. These limitations, however, also may make a change of control significantly more

## Edgar Filing: PUBLIC STORAGE INC /CA - Form 10-Q

difficult (if not impossible) even if it would be favorable to the interests of our public shareholders. These provisions will prevent future takeover attempts not approved by our board of directors even if a majority of our public shareholders deem it to be in their best interests because they would receive a premium for their shares over the shares' then market value or for other reasons.

WE WOULD INCUR ADVERSE TAX CONSEQUENCES IF WE OR SHURGARD FAILED TO QUALIFY AS A REIT.

We have assumed based on public filings that Shurgard qualified as a real estate investment trust for United States federal income tax purposes, referred to hereinafter as a REIT and that we will be able to continue to qualify as a REIT following the Shurgard merger. However, if Shurgard failed to qualify as a REIT, we generally would have succeeded to or incurred significant tax liabilities (including the significant tax liability that would have resulted from the deemed sale of assets by Shurgard pursuant to the merger) and we could possibly lose our REIT status should disqualifying activities continue after the Shurgard merger.

Investors are also subject to the risk that we may not qualify as a REIT. REITs are subject to a range of complex organizational and operational requirements. As a REIT, we must distribute with respect to each year at least 90% of our REIT taxable income to our shareholders. Other restrictions apply to our income and assets. Our REIT status is also dependent upon the ongoing qualification of our affiliate, PS Business Parks, Inc., as a REIT, as a result of our substantial ownership interest in that company.

For any taxable year that we fail to qualify as a REIT and are unable to avail ourselves of certain savings provisions set forth in the Internal Revenue Code of 1986, we would be subject to federal income tax at the regular

85

corporate rates on all of our taxable income, whether or not we make any distributions to our shareholders. Those taxes would reduce the amount of cash available for distribution to our shareholders or for reinvestment and would adversely affect our earnings. As a result, our failure to qualify as a REIT during any taxable year could have a material adverse effect upon us and our shareholders. Furthermore, unless certain relief provisions apply, we would not be eligible to elect REIT status again until the fifth taxable year that begins after the first year for which we fail to qualify.

WE MAY PAY SOME TAXES, REDUCING CASH AVAILABLE FOR SHAREHOLDERS.

Even if we qualify as a REIT for federal income tax purposes, we are required to pay some federal, state and local taxes on our income and property. Several corporate subsidiaries of the Company have elected to be treated as "taxable REIT subsidiaries" of the Company for federal income tax purposes since January 1, 2001. A taxable REIT subsidiary is taxable as a regular corporation and is limited in its ability to deduct interest payments made to us in excess of a certain amount. In addition, if we receive certain payments and the economic arrangements among our taxable REIT subsidiaries and us are not comparable to similar arrangements among unrelated parties we will be subject to a 100% penalty tax on those payments. To the extent that the Company or any taxable REIT subsidiary is required to pay federal, state or local taxes, we will have less cash available for distribution to shareholders.

WE HAVE BECOME INCREASINGLY DEPENDENT UPON AUTOMATED PROCESSES AND THE INTERNET AND ARE FACED WITH SECURITY SYSTEM RISKS.

## Edgar Filing: PUBLIC STORAGE INC /CA - Form 10-Q

We have become increasingly centralized and dependent upon automated information technology processes. As a result, we could be severely impacted by a catastrophic occurrence, such as a natural disaster or a terrorist attack. In addition, a portion of our business operations are conducted over the Internet, increasing the risk of viruses that could cause system failures and disruptions of operations. Experienced computer programmers may be able to penetrate our network security and misappropriate our confidential information, create system disruptions or cause shutdowns.

CERTAIN SECURITIES HAVE A LIQUIDATION PREFERENCE OVER OUR COMMON STOCK AND EQUITY STOCK, SERIES A.

If we liquidated, holders of our preferred securities would be entitled to receive liquidating distributions, plus any accrued and unpaid distributions, before any distribution of assets to the holders of our common stock and equity stock, series A. Holders of preferred securities are entitled to receive, when declared by our board of directors, cash distributions in preference to holders of our common stock and equity stock, Series A.

SINCE OUR BUSINESS CONSISTS PRIMARILY OF ACQUIRING AND OPERATING REAL ESTATE, WE ARE SUBJECT TO REAL ESTATE OPERATING RISKS.

The value of our investments may be reduced by general risks of real estate ownership. Since we derive substantially all of our income from real estate operations, we are subject to the general risks of owning real estate-related assets, including:

- o lack of demand for rental spaces or units in a locale;

- o changes in general economic or local conditions;
- o natural disasters, such as earthquakes;
- o potential terrorist attacks;
- o changes in supply of or demand for similar or competing facilities in an area;
- o the impact of environmental protection laws;
- o changes in interest rates and availability of permanent mortgage funds which may render the sale or financing of a property difficult or unattractive;
- o changes in tax, real estate and zoning laws; and
- o tenant claims.

In addition, we self-insure certain of our property loss, liability, and workers compensation risks for which other real estate companies may use third-party insurers. This results in a higher risk of losses that are not covered by third-party insurance contracts, as described in Note 16 under "Insurance and Loss Exposure" to our consolidated financial statements included in this quarterly report on Form 10-Q for the quarter ended September 30, 2006.

There is significant competition among self-storage facilities and from other storage alternatives. Most of our properties are self-storage facilities, which generated most of our revenue for the nine months ended September 30, 2006. Local market conditions will play a significant part in how competition will affect us. Competition in the market areas in which many of our properties

## Edgar Filing: PUBLIC STORAGE INC /CA - Form 10-Q

are located from other self-storage facilities and other storage alternatives is significant and has affected the occupancy levels, rental rates and operating expenses of some of our properties. Any increase in availability of funds for investment in real estate may accelerate competition. Further development of self-storage facilities may intensify competition among operators of self-storage facilities in the market areas in which we operate.

We may incur significant environmental costs and liabilities. As an owner and operator of real properties, under various federal, state and local environmental laws, we are required to clean up spills or other releases of hazardous or toxic substances on or from our properties. Certain environmental laws impose liability whether or not the owner knew of, or was responsible for, the presence of the hazardous or toxic substances. In some cases, liability may not be limited to the value of the property. The presence of these substances, or the failure to properly remediate any resulting contamination, whether from environmental or microbial issues, also may adversely affect the owner's or operator's ability to sell, lease or operate its property or to borrow using its property as collateral.

We have conducted preliminary environmental assessments of most of our properties (and intend to conduct these assessments in connection with property acquisitions) to evaluate the environmental condition of, and potential environmental liabilities associated with, our properties. These assessments generally consist of an investigation of environmental conditions at the property (not including soil or groundwater sampling or analysis), as well as a review of available information regarding the site and publicly available data regarding conditions at other sites in the vicinity. In connection with these property assessments, our operations and recent property acquisitions, we have become aware that prior operations or activities at some facilities or from nearby locations have or may have resulted in contamination to the soil or groundwater at these facilities. In this regard, some of our facilities are or may be the subject of federal or state environment investigations or remedial actions. We have obtained, with respect to recent acquisitions, and intend to obtain with respect to pending or future acquisitions, appropriate purchase price adjustments or indemnifications that we believe are sufficient to cover any related potential liability. Although we cannot provide any assurance, based on the preliminary environmental assessments, we believe we have funds available to cover any liability from environmental contamination or potential contamination and we are not aware of any environmental contamination of our facilities material to our overall business, financial condition or results of operation.

There has been an increasing number of claims and litigation against owners and managers of rental properties relating to moisture infiltration, which can result in mold or other property damage. When we receive a complaint concerning moisture infiltration, condensation or mold problems and/or become aware that an air quality concern exists, we implement corrective measures in accordance with guidelines and protocols we have developed with the assistance of outside experts. We seek to work proactively with our tenants to resolve moisture infiltration and mold-related issues, subject to our contractual limitations on liability for such claims. However, we can make no assurance that material legal claims relating to moisture infiltration and the presence of, or exposure to, mold will not arise in the future.

Delays in development and fill-up of our properties would reduce our profitability. Since January 1, 2002, through September 30, 2006, we have opened 44 newly developed self-storage facilities and 17 facilities that combine self-storage and containerized storage space at the same location, with aggregate development costs of approximately \$538.9 million. In addition, our development efforts in the United States and Europe at September 30, 2006 consist of 60 projects with total estimated costs of \$328 million. We anticipate the development of these 60 projects to be completed in the next two years.

## Edgar Filing: PUBLIC STORAGE INC /CA - Form 10-Q

Construction delays due to weather, unforeseen site conditions, personnel problems, and other factors, as well as cost overruns, would adversely affect our profitability. Delays in the rent-up of newly developed facilities as a result of competition or other factors would also adversely impact our profitability.

87

Property taxes can increase and cause a decline in yields on investments. Each of our properties is subject to real property taxes. These real property taxes may increase in the future as property tax rates change and as our properties are assessed or reassessed by tax authorities. Such increases could adversely impact our profitability.

We must comply with the Americans with Disabilities Act and fire and safety regulations, which can require significant expenditures. All our properties must comply with the Americans with Disabilities Act and with related regulations (the "ADA"). The ADA has separate compliance requirements for "public accommodations" and "commercial facilities," but generally requires that buildings be made accessible to persons with disabilities. Various state laws impose similar requirements. A failure to comply with the ADA or similar state laws could result in government imposed fines on us and could award damages to individuals affected by the failure. In addition, we must operate our properties in compliance with numerous local fire and safety regulations, building codes, and other land use regulations. Compliance with these requirements can require us to spend substantial amounts of money, which would reduce cash otherwise available for distribution to shareholders. Failure to comply with these requirements could also affect the marketability of our real estate facilities.

Any failure by us to manage acquisitions and other significant transactions successfully could negatively impact our financial results. As an increasing part of our business, we acquire other self-storage facilities. We also evaluate from time to time other significant transactions. If these facilities are not properly integrated into our system, our financial results may suffer.

We incur liability from employment related claims. From time to time we must resolve employment related claims by corporate level and field personnel.

WE HAVE NO INTEREST IN CANADIAN SELF-STORAGE FACILITIES OWNED BY THE HUGHES FAMILY.

The Hughes Family has ownership interests in, and operates, approximately 44 self-storage facilities in Canada under the name "Public Storage." We currently do not own any interests in these facilities nor do we own any facilities in Canada. We have a right of first refusal to acquire the stock or assets of the corporation engaged in the operation of the self-storage facilities in Canada if the Hughes family or the corporation agrees to sell them. However, we have no ownership interest in the operations of this corporation, have no right to acquire their stock or assets unless the Hughes family decides to sell, and receive no benefit from the profits and increases in value of the Canadian self-storage facilities.

Prior to December 31, 2003, Company personnel were engaged in the supervision and the operation of these properties and provided certain administrative services for the Canadian owners, and certain other services, primarily tax services, with respect to certain other Hughes Family interests. The Hughes Family and the Canadian owners reimbursed us at cost for these services in the amount of \$542,499 with respect to the Canadian operations and \$151,063 for other services during 2003 (in United States dollars). There were conflicts of interest in allocating time of our personnel between Company

## Edgar Filing: PUBLIC STORAGE INC /CA - Form 10-Q

properties, the Canadian properties, and certain other Hughes Family interests. The sharing of Company personnel with the Canadian entities was substantially eliminated by December 31, 2003.

Through our subsidiaries, we continue to reinsure risks relating to loss of goods stored by tenants in the self-storage facilities in Canada. We acquired the tenant insurance business on December 31, 2001 through our acquisition of PSIC. For each of the nine-month periods ended September 30, 2006 and 2005, PSIC received \$759,000 and \$795,000, respectively, in reinsurance premiums attributable to the Canadian Facilities. Since PSIC's right to provide tenant reinsurance to the Canadian Facilities may be qualified, there is no assurance that these premiums will continue.

OUR CONTAINERIZED STORAGE BUSINESS HAS INCURRED OPERATING LOSSES.

Public Storage Pickup & Delivery ("PSPUD") was organized in 1996 to operate a containerized storage business. We own all of the economic interest of PSPUD. Since PSPUD will operate profitably only if it can succeed in the relatively new field of containerized storage, we cannot provide any assurance as to its profitability. PSPUD incurred an operating loss of \$10,058,000 in 2002, and generated operating profits of \$2,543,000 in 2003, \$684,000 in 2004, \$1,818,000 for 2005 and \$385,000 for the nine months ended September 30, 2006. Since 2002, PSPUD closed or consolidated facilities that were deemed not strategic to its business plan, and had 12 facilities open at September 30, 2006.

88

INCREASES IN INTEREST RATES MAY ADVERSELY AFFECT THE PRICE OF OUR COMMON STOCK.

One of the factors that influences the market price of our common stock and our other securities is the annual rate of distributions that we pay on the securities, as compared with interest rates. An increase in interest rates may lead purchasers of REIT shares to demand higher annual distribution rates, which could adversely affect the market price of our common stock and other securities.

TERRORIST ATTACKS AND THE POSSIBILITY OF WIDER ARMED CONFLICT MAY HAVE AN ADVERSE IMPACT ON OUR BUSINESS AND OPERATING RESULTS AND COULD DECREASE THE VALUE OF OUR ASSETS.

Terrorist attacks and other acts of violence or war, such as those that took place on September 11, 2001, could have a material adverse impact on our business and operating results. There can be no assurance that there will not be further terrorist attacks against the United States or its businesses or interests. Attacks or armed conflicts that directly impact one or more of our properties could significantly affect our ability to operate those properties and thereby impair our operating results. Further, we may not have insurance coverage for losses caused by a terrorist attack. Such insurance may not be available, or if it is available and we decide to obtain such terrorist coverage, the cost for the insurance may be significant in relationship to the risk overall. In addition, the adverse effects that such violent acts and threats of future attacks could have on the United States economy could similarly have a material adverse effect on our business and results of operations. Finally, further terrorist acts could cause the United States to enter into a wider armed conflict, which could further impact our business and operating results.

DEVELOPMENTS IN CALIFORNIA MAY HAVE AN ADVERSE IMPACT ON OUR BUSINESS.

We are headquartered in, and approximately one-fifth of our properties

## Edgar Filing: PUBLIC STORAGE INC /CA - Form 10-Q

in the United States are located in, California. California is facing budgetary problems. Action that may be taken in response to these problems, such as an increase in property taxes on commercial properties, could adversely impact our business and results of operations. In addition, we could be adversely impacted by efforts to reenact legislation mandating medical insurance for employees of California businesses and members of their families.

### ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

-----

On June 12, 1998, we announced that the Board of Directors (the "Directors") authorized the repurchase from time to time of up to 10,000,000 shares of the Company's common stock on the open market or in privately negotiated transactions. On subsequent dates the Directors increased the repurchase authorization, the last being April 13, 2001, when the Board of Directors increased the repurchase authorization to 25,000,000 shares. The Company has repurchased a total of 22,201,720 shares of Common Stock under this authorization. The Company did not repurchase any shares of Common Stock during the nine months ended September 30, 2006.

### ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

-----

The Company held its annual meeting of shareholders on August 22, 2006, and the following matters were voted on at the meeting:

1. The election of the following directors for the succeeding year or until their successors are duly qualified and elected:

89

Name	Total Votes	
	Total Votes For	Total Votes Withheld
B. Wayne Hughes	81,995,900	32,355,081
Ronald L. Havner, Jr.	112,061,211	2,289,770
Robert J. Abernethy	102,833,568	11,517,413
Dann V. Angeloff	109,438,064	4,912,918
William C. Baker	111,647,148	2,703,834
John T. Evans	103,509,361	10,841,621
Uri P. Harkham	112,426,967	1,924,014
B. Wayne Hughes, Jr.	82,165,618	32,185,364
Harvey Lenkin	112,011,694	2,339,288
Daniel C. Staton	103,522,945	10,828,036

2. The shareholders approved the merger agreement dated as of March 6, 2006 by and among Public Storage, Inc., Shurgard Storage Centers, Inc., and ASKL Sub LLC and the transactions contemplated thereby, including the issuance of Public Storage common stock. Of the shares of common stock voted at the meeting, 104,832,667 votes were cast in favor of the merger agreement; 255,745 shares voted against; 645,790 shares abstained; and 8,034,510 were broker non-votes. Of the Company's shares of Equity Stock, Series A and Equity Stock, Series AAA voting together as a class, 4,524,362 votes were cast in favor of the merger agreement, 8,614 shares voted against; 3,187 shares abstained; and 335,650 were broker non-votes.
3. The shareholders approved ratification of the appointment of Ernst & Young LLP as the Company's independent auditors for the fiscal year ended December 31, 2006. There were 100,506,454 votes cast for ratification;

## Edgar Filing: PUBLIC STORAGE INC /CA - Form 10-Q

12,899,735 votes cast against ratification; and 944,792 votes abstained.

### ITEM 6. EXHIBITS

Exhibits required by Item 601 of Regulation S-K are filed herewith or incorporated herein by reference and are listed in the attached Exhibit Index which is incorporated herein by reference.

90

### SIGNATURES

Pursuant to the requirement 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.

DATED: November 9, 2006

PUBLIC STORAGE, INC.

By: /s/ John Reyes

-----  
John Reyes  
Senior Vice President and Chief  
Financial Officer (Principal  
financial officer and duly  
authorized officer)

91

Exhibit No.	Exhibit Index
-----	-----
3.1	Restated Articles of Incorporation of Storage Equities, Inc. Filed with Registrant's Registration Statement on Form S-4 (SEC File No. 33-54557) and incorporated herein by reference.
3.2	Certificate of Amendment of Articles of Incorporation of Storage Equities, Inc. Filed with Registrant's Registration Statement on Form S-3/A (SEC File No. 33-63947) and incorporated herein by reference.
3.3	Certificate of Amendment of Articles of Incorporation of Public Storage, Inc. Filed with Registrant's Registration Statement on Form S-3 (SEC File No. 333-18395) and incorporated herein by reference.
3.4	Certificate of Determination of Preferences of 10% Cumulative Preferred Stock, Series A of Storage Equities, Inc. Filed with Registrant's Registration Statement on Form S-4 (SEC File No. 33-54557) and incorporated herein by reference.
3.5	Amendment to Certificate of Determination of Preferences of 10% Cumulative Preferred Stock, Series A of Public Storage, Inc. Filed with the Registrant's Quarterly Report on Form 10-Q for the quarterly period ended March 31, 2004 and incorporated herein by



## Edgar Filing: PUBLIC STORAGE INC /CA - Form 10-Q

reference.

- 3.6 Certificate of Determination of Preferences of 9.20% Cumulative Preferred Stock, Series B of Storage Equities, Inc. Filed with Registrant's Registration Statement on Form S-4 (SEC File No. 33-54557) and incorporated herein by reference.
- 3.7 Amendment to Certificate of Determination of Preferences of 9.20% Cumulative Preferred Stock, Series B of Storage Equities, Inc. Filed with Registrant's Registration Statement on Form S-4 (SEC File No. 33-56925) and incorporated herein by reference.
- 3.8 Amendment to Certificate of Determination of Preferences of 9.20% Cumulative Preferred Stock, Series B of Public Storage, Inc. Filed with the Registrant's Quarterly Report on Form 10-Q for the quarterly period ended June 30, 2004 and incorporated herein by reference.
- 3.9 Certificate of Determination of Preferences of 8.25% Convertible Preferred Stock of Public Storage, Inc. Filed with Registrant's Registration Statement on Form S-4 (SEC File No. 33-54557) and incorporated herein by reference.
- 3.10 Certificate of Determination of Preferences of Adjustable Rate Cumulative Preferred Stock, Series C of Storage Equities, Inc. Filed with Registrant's Registration Statement on Form S-4 (SEC File No. 33-54557) and incorporated herein by reference.
- 3.11 Amendment to Certificate of Determination of Preferences of Adjustable Rate Cumulative Preferred Stock, Series C of Public Storage, Inc. Filed with Registrant's Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2004 and incorporated herein by reference.
- 3.12 Certificate of Determination of Preferences of 9.50% Cumulative Preferred Stock, Series D of Storage Equities, Inc. Filed with Registrant's Registration Statement on Form 8-A/A relating to the 9.50% Cumulative Preferred Stock, Series D and incorporated herein by reference.
- 3.13 Amendment to Certificate of Determination of Preferences of 9.50% Cumulative Preferred Stock, Series D of Public Storage, Inc. Filed with Registrant's Annual Report on Form 10-K for the year ended December 31, 2004 and incorporated herein by reference.
- 3.14 Certificate of Determination of Preferences of 10% Cumulative Preferred Stock, Series E of Storage Equities, Inc. Filed with Registrant's Registration Statement on Form 8-A/A relating to the 10% Cumulative Preferred Stock, Series E and incorporated herein by reference.
- 3.15 Amendment to Certificate of Determination of Preferences of 10% Cumulative Preferred Stock, Series E of Public Storage, Inc. Filed with Registrant's Current Report on Form 8-K dated April 25, 2005 and incorporated herein by reference.
- 3.16 Certificate of Determination of Preferences of 9.75% Cumulative Preferred Stock, Series F of Storage Equities, Inc. Filed with

## Edgar Filing: PUBLIC STORAGE INC /CA - Form 10-Q

Registrant's Registration Statement on Form 8-A/A relating to the 9.75% Cumulative Preferred Stock, Series F and incorporated herein by reference.

- 3.17 Amendment to Certificate of Determination of Preferences of 9.750% Cumulative Preferred Stock, Series F of Public Storage, Inc. Filed with Registrant's Current Report on Form 8-K dated August 17, 2005 and incorporated herein by reference.
- 3.18 Certificate of Determination of Preferences of 8-7/8% Cumulative Preferred Stock, Series G of Public Storage, Inc. Filed with Registrant's Registration Statement on Form 8-A/A relating to the Depositary Shares Each Representing 1/1,000 of a Share of 8-7/8% Cumulative Preferred Stock, Series G and incorporated herein by reference.
- 3.19 Certificate of Determination of Preferences of 8.45% Cumulative Preferred Stock, Series H of Public Storage, Inc. Filed with Registrant's Registration Statement on Form 8-A/A relating to the Depositary Shares Each Representing 1/1,000 of a Share of 8.45% Cumulative Preferred Stock, Series H and incorporated herein by reference.
- 3.20 Certificate of Determination of Preferences of Convertible Preferred Stock, Series CC of Public Storage, Inc. Filed with Registrant's Registration Statement on Form S-4 (SEC File No. 333-03749) and incorporated herein by reference.
- 3.21 Certificate of Correction of Certificate of Determination of Preferences of Convertible Participating Preferred Stock of Public Storage, Inc. Filed with Registrant's Registration Statement on Form S-4 (SEC File No. 333-08791) and incorporated herein by reference.
- 3.22 Certificate of Determination of Preferences of 8 5/8% Cumulative Preferred Stock, Series I of Public Storage, Inc. Filed with Registrant's Registration Statement on Form 8-A/A relating to the Depositary Shares Each Representing 1/1,000 of a Share of 8 5/8% Cumulative Preferred Stock, Series I and incorporated herein by reference.
- 3.23 Certificate of Determination of Equity Stock, Series A of Public Storage, Inc. Filed with Registrant's Quarterly Report on Form 10-Q for the quarterly period ended June 30, 1997 and incorporated herein by reference.
- 3.24 Certificate of Determination of Preferences of 8% Cumulative Preferred Stock, Series J of Public Storage, Inc. Filed with Registrant's Registration Statement on Form 8-A/A relating to the Depositary Shares Each Representing 1/1,000 of a Share of 8% Cumulative Preferred Stock, Series J and incorporated herein by reference.
- 3.25 Certificate of Correction of Certificate of Determination of Preferences of 8.25% Convertible Preferred Stock of Public Storage, Inc. Filed with Registrant's Registration Statement on Form S-4 (SEC File No. 333-61045) and incorporated herein by reference.
- 3.26 Certificate of Determination of Preferences of 8 1/4% Cumulative Preferred Stock, Series K of Public Storage, Inc. Filed with Registrant's Registration Statement on Form 8-A/A relating to the Depositary Shares Each Representing 1/1,000 of a Share of 8 1/4%

## Edgar Filing: PUBLIC STORAGE INC /CA - Form 10-Q

Cumulative Preferred Stock, Series K and incorporated herein by reference.

3.27 Certificate of Determination of Preferences of 8 1/4% Cumulative Preferred Stock, Series L of Public Storage, Inc. Filed with Registrant's Registration Statement on Form 8-A/A relating to the Depositary Shares Each Representing 1/1,000 of a Share of 8 1/4% Cumulative Preferred Stock, Series L and incorporated herein by reference.

3.28 Certificate of Determination of Preferences of 8.75% Cumulative Preferred Stock, Series M of Public Storage, Inc. Filed with Registrant's Registration Statement on Form 8-A/A relating to the Depositary Shares Each Representing 1/1,000 of a Share of 8.75% Cumulative Preferred Stock, Series M and incorporated herein by reference.

93

3.29 Certificate of Determination of Equity Stock, Series AA of Public Storage, Inc. Filed with Registrant's Quarterly Report on Form 10-Q for the quarterly period ended September 30, 1999 and incorporated herein by reference.

3.30 Certificate Decreasing Shares Constituting Equity Stock, Series A of Public Storage, Inc. Filed with Registrant's Quarterly Report on Form 10-Q for the quarterly period ended September 30, 1999 and incorporated herein by reference.

3.31 Certificate of Determination of Equity Stock, Series A of Public Storage, Inc. Filed with Registrant's Quarterly Report on Form 10-Q for the quarterly period ended September 30, 1999 and incorporated herein by reference.

3.32 Certificate of Amendment of Certificate of Determination of Equity Stock, Series A of Public Storage, Inc. Filed with Registrant's Quarterly Report on Form 10-Q for the quarterly period ended June 30, 2001 and incorporated herein by reference.

3.33 Certificate of Determination of Equity Stock, Series AAA of Public Storage, Inc. Filed with Registrant's Current Report on Form 8-K dated November 15, 1999 and incorporated herein by reference.

3.34 Certificate of Determination of Preferences of 9.5% Cumulative Preferred Stock, Series N of Public Storage, Inc. Filed with Registrant's Annual Report on Form 10-K for the year ended December 31, 1999 and incorporated herein by reference.

3.35 Certificate of Determination of Preferences of 9.125% Cumulative Preferred Stock, Series O of Public Storage, Inc. Filed with Registrant's Quarterly Report on Form 10-Q for the quarterly period ended March 31, 2000 and incorporated herein by reference.

3.36 Certificate of Determination of Preferences of 8.75% Cumulative Preferred Stock, Series P of Public Storage, Inc. Filed with Registrant's Quarterly Report on Form 10-Q for the quarterly period ended June 30, 2000 and incorporated herein by reference.

3.37 Certificate of Determination of Preferences of 8.600% Cumulative Preferred Stock, Series Q of Public Storage, Inc. Filed with Registrant's Registration Statement on Form 8-A/A (No. 001-08389)

## Edgar Filing: PUBLIC STORAGE INC /CA - Form 10-Q

relating to the Depositary Shares Each Representing 1/1,000 of a Share of 8.600% Cumulative Preferred Stock, Series Q and incorporated herein by reference.

- 3.38 Certificate of Amendment of Certificate of Determination of Equity Stock, Series A of Public Storage, Inc. Filed with Registrant's Quarterly Report on Form 10-Q for the quarterly period ended June 30, 2001 and incorporated herein by reference.
- 3.39 Certificate of Determination of Preferences of 8.000% Cumulative Preferred Stock, Series R of Public Storage, Inc. Filed with Registrant's Registration Statement on Form 8-A relating to the Depositary Shares Each Representing 1/1,000 of a Share of 8.000% Cumulative Preferred Stock, Series R and incorporated herein by reference.
- 3.40 Certificate of Determination of Preferences of 7.875% Cumulative Preferred Stock, Series S of Public Storage, Inc. Filed with Registrant's Registration Statement on Form 8-A relating to the Depositary Shares Each Representing 1/1,000 of a Share of 7.875% Cumulative Preferred Stock, Series S and incorporated herein by reference.
- 3.41 Certificate of Determination of Preferences of 7.625% Cumulative Preferred Stock, Series T of Public Storage, Inc. Filed with Registrant's Registration Statement on Form 8-A relating to the Depositary Shares Each Representing 1/1,000 of a Share of 7.625% Cumulative Preferred Stock, Series T and incorporated herein by reference.
- 3.42 Certificate of Determination of Preferences of 7.625% Cumulative Preferred Stock, Series U of Public Storage, Inc. Filed with Registrant's Registration Statement on Form 8-A relating to Depositary Shares Each Representing 1/1,000 of a Share of 7.625% Cumulative Preferred Stock, Series U and incorporated herein by reference.
- 94
- 3.43 Amendment to Certificate of Determination of Preferences of 7.625% Cumulative Preferred Stock, Series T of Public Storage, Inc. Filed with Registrant's Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2002 and incorporated herein by reference.
- 3.44 Certificate of Determination of Preferences of 7.500% Cumulative Preferred Stock, Series V of Public Storage, Inc. Filed with Registrant's Registration Statement Form 8-A relating to the Depositary Shares Each Representing 1/1,000 of a Share of 7.500% Cumulative Preferred Stock, Series V and incorporated herein by reference.
- 3.45 Certificate of Determination of Preferences of 6.500% Cumulative Preferred Stock, Series W of Public Storage, Inc. Filed with Registrant's Registration Statement Form 8-A relating to the Depositary Shares Each Representing 1/1,000 of a Share of 6.500% Cumulative Preferred Stock, Series W and incorporated herein by reference.
- 3.46 Certificate of Determination of Preferences 6.450% Cumulative Preferred Stock, Series X of Public Storage, Inc. Filed with

## Edgar Filing: PUBLIC STORAGE INC /CA - Form 10-Q

- Registrant's Registration Statement on Form 8-A relating to the Depository Shares Each Representing 1/1,000 of a Share of 6.450% Cumulative Preferred Stock, Series X and incorporated herein by reference.
- 3.47 Certificate of Determination of Preferences of 6.85% Cumulative Preferred Stock, Series Y of Public Storage, Inc. Filed with the Registrant's Quarterly Report on Form 10-Q for the quarterly period ended March 31, 2004 and incorporated herein by reference.
- 3.48 Certificate of Determination of Preferences of 6.250% Cumulative Preferred Stock, Series Z of Public Storage, Inc. Filed with Registrant's Registration Statement on Form 8-A relating to the Depository Shares Each Representing 1/1,000 of a Share of 6.250% Cumulative Preferred Stock, Series Z and incorporated herein by reference.
- 3.49 Certificate of Determination of Preferences of 6.125% Cumulative Preferred Stock, Series A of Public Storage, Inc. Filed with Registrant's Registration Statement on Form 8-A relating to the Depository Shares Each Representing 1/1,000 of a Share of 6.125% Cumulative Preferred Stock, Series A and incorporated herein by reference.
- 3.50 Certificate of Determination of Preferences of 6.40% Cumulative Preferred Stock, Series NN of Public Storage, Inc. Filed with Registrant's Quarterly Report on Form 10-Q for the quarterly period ended March 31, 2004 and incorporated herein by reference.
- 3.51 Certificate of Determination of Preferences of 7.125% Cumulative Preferred Stock, Series B of Public Storage, Inc. Filed with Registrant's Registration Statement on Form 8-A relating to the Depository Shares Each Representing 1/1,000 of a Share of 7.125% Cumulative Preferred Stock, Series B and incorporated herein by reference.
- 3.52 Certificate of Determination of Preferences of 6.60% Cumulative Preferred Stock, Series C of Public Storage, Inc. Filed with Registrant's Registration Statement on Form 8-A relating to the Depository Shares Each Representing 1/1,000 of a Share of 6.60% Cumulative Preferred Stock, Series C and incorporated herein by reference.
- 3.53 Certificate of Determination of Preferences of 6.18% Cumulative Preferred Stock, Series D of Public Storage, Inc. Filed with Registrant's Registration Statement on Form 8-A relating to the Depository Shares Each Representing 1/1,000 of a Share of 6.18% Cumulative Preferred Stock, Series D and incorporated herein by reference.
- 3.54 Certificate of Determination of Preferences of 6.75% Cumulative Preferred Stock, Series E of Public Storage, Inc. Filed with Registrant's Registration Statement on Form 8-A relating to the Depository Shares Each Representing 1/1,000 of a share of 6.75% Cumulative Preferred Stock, Series E and incorporated herein by reference.
- 3.55 Certificate of Determination of Preferences of 6.45% Cumulative Preferred Stock, Series F of Public Storage, Inc. Filed with Registrant's Registration Statement on Form 8-A relating to the Depository Shares Each Representing 1/1,000 of a Share of 6.45% Cumulative Preferred Stock, Series F and incorporated herein by

## Edgar Filing: PUBLIC STORAGE INC /CA - Form 10-Q

reference.

95

- 3.56 Amendment to Certificate of Determination of Preferences 6.45% Cumulative Preferred Stock, Series F of Public Storage, Inc. Filed with Registrant's Registration Statement on Form 8-A relating to the Depositary Shares Each Representing 1/1,000 of a Share of 6.45% Cumulative Preferred Stock, Series F and incorporated herein by reference.
- 3.57 Certificate of Determination of Preferences of 7.00% Cumulative Preferred Stock, Series G of Public Storage, Inc. Filed with Registrant's Registration Statement on Form 8-A relating to the Depositary Shares Each Representing 1/1,000 of a Share of 7.00% Cumulative Preferred Stock, Series G and incorporated herein by reference.
- 3.58 Certificate of Determination of Preferences of 6.95% Cumulative Preferred Stock, Series H of Public Storage, Inc. Filed with Registrant's Registration Statement on Form 8-A relating to the Depositary Shares Each Representing 1/1,000 of a Share of 6.95% Cumulative Preferred Stock, Series H and incorporated herein by reference.
- 3.59 Certificate of Determination of Preferences of 7.25% Cumulative Preferred Stock, Series I of Public Storage, Inc. Filed with Registrant's Registration Statement on Form 8-A relating to the Depositary Shares Each Representing 1/1,000 of a Share of 7.25% Cumulative Preferred Stock, Series I and incorporated herein by reference.
- 3.60 Certificate of Determination of Preferences of 7.25% Cumulative Preferred Stock, Series J of Public Storage, Inc. Filed with Registrant's Current Report on Form 8-K filed May 9, 2006 relating to the Depositary Shares Each Representing 1/1,000 of a Share of 7.25% Cumulative Preferred Stock, Series J and incorporated herein by reference.
- 3.61 Certificate of Determination of Preferences of 7.25% Cumulative Preferred Stock, Series K of Public Storage, Inc. Filed with Registrant's Current Report on Form 8-K filed August 4, 2006 relating to the Depositary Shares Each Representing 1/1,000 of a Share of 7.25% Cumulative Preferred Stock, Series K and incorporated herein by reference.
- 3.62 Certificate of Determination of Preferences of 6.75% Cumulative Preferred Stock, Series L of Public Storage, Inc. Filed with Registrant's Current Report on Form 8-K filed October 18, 2006 relating to the Depositary Shares Each Representing 1/1,000 of a Share of 6.75% Cumulative Preferred Stock, Series L and incorporated herein by reference.
- 3.63 Amendment to Certificate of Determination of Determination of Preferences of Cumulative Preferred Stock, Series G (8.875%), H (8.45%), I (8.625%), J (8%), K (8.25%), L (8.25%), M (8.75%), N (9.5%), O (9.125%) and P (8.75%) of Public Storage, Inc. Filed with Registrant's Current Report on Form 8-K dated November 22, 2005 and incorporated herein by reference.
- 3.64 Revised Bylaws of Storage Equities, Inc. Filed with Registrant's

## Edgar Filing: PUBLIC STORAGE INC /CA - Form 10-Q

Registration Statement on Form S-4/A (SEC File No. 33-64971) and incorporated herein by reference.

- 3.65 Amendment to Bylaws of Public Storage, Inc. adopted on May 9, 1996. Filed with Registrant's Registration Statement on Form S-4 (Sec File No. 333-03749) and incorporated herein by reference.
- 3.66 Amendment to Bylaws of Public Storage, Inc. adopted on June 26, 1997. Filed with Registrant's Registration Statement on Form S-3/A (SEC File No. 333-41123) and incorporated herein by reference.
- 3.67 Amendment to Bylaws of Public Storage, Inc. adopted on January 6, 1998. Filed with Registrant's Registration Statement on Form S-3/A (SEC File No. 333-41123) and incorporated herein by reference.
- 3.68 Amendment to Bylaws of Public Storage, Inc. adopted on February 10, 1998. Filed with Registrant's Current Report on Form 8-K dated February 10, 1998 and incorporated herein by reference.
- 3.69 Amendment to Bylaws of Public Storage, Inc. adopted on March 4, 1999. Filed with Registrant's Current Report on Form 8-K dated March 4, 1999 and incorporated herein by reference.

96

- 3.70 Amendment to Bylaws of Public Storage, Inc. adopted on May 6, 1999. Filed with Registrant's Quarterly Report on Form 10-Q for the quarterly period ended March 31, 1999 and incorporated herein by reference.
- 3.71 Amendment to Bylaws of Public Storage, Inc. adopted on November 7, 2002. Filed with Registrant's Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2002 and incorporated herein by reference.
- 3.72 Amendment to Bylaws of Public Storage, Inc. adopted on May 8, 2003. Filed with Registrant's Quarterly Report on Form 10-Q for the quarterly period ended March 31, 2003 and incorporated herein by reference.
- 3.73 Amendment to Bylaws of Public Storage, Inc. adopted on August 5, 2003. Filed with Registrant's Quarterly Report on Form 10-Q for the quarterly period ended June 30, 2003 and incorporated herein by reference.
- 3.74 Amendment to Bylaws of Public Storage, Inc. adopted on March 11, 2004. Filed with Registrant's Annual Report on Form 10-K for the year ended December 31, 2003 and incorporated herein by reference.
- 3.75 Amendments to Bylaws of Public Storage, Inc. adopted on August 22, 2006. Filed with Registrant's Current Report on Form 8-K filed August 23, 2006 and incorporated herein by reference.
- 4.1 Registration Rights Agreement dated as of May 9, 2006 relating to 7.25% Series J Cumulative Preferred Stock of the Registrant. Filed with Registrant's Current Report on Form 8-K dated May 9, 2006 and incorporated herein by reference.
- 4.2 Indenture dated April 25, 1997, between Shurgard Storage Centers Inc. ("Shurgard") and LaSalle National Bank, as Trustee. Incorporated by reference to Exhibit 10 to the Quarterly Report on

## Edgar Filing: PUBLIC STORAGE INC /CA - Form 10-Q

Form 10-Q for the quarter ended March 31, 1997 filed by Shurgard (SEC File No. 0-11455).

- 4.3 Supplemental Indenture dated July 11, 1997. Incorporated by reference to Exhibit 4.4 to the Annual Report on Form 10-K for the year ended December 31, 1997 filed by Shurgard
- 4.4 Form of 7(5)/8% Notes due 2007. Incorporated by reference to Exhibit 4.2 to the Current Report on Form 8-K dated April 22, 1997 filed by Shurgard
- 4.5 Form of 7(3)/4% Notes due 2011. Incorporated by reference to Exhibit 4.4 to the Registration Statement on Form S-4 filed on June 20, 2001 filed by Shurgard
- 4.6 Form of 5.875% Notes due 2013. Incorporated by reference to Exhibit 4.1 to the Current Report on Form 8-K dated March 20, 2003 filed by Shurgard.
- 10.1. Deposit Agreement dated as of August 8, 2006 among Registrant and Computershare Trust Company N.A. and the holders of depositary receipts evidencing the Depositary Shares Each Representing 1/1,000 of a share of 7.25% Cumulative Preferred Stock, Series K. Filed with Registrant's Registration Statement on Form 8-A relating to the Depositary Shares Each Representing 1/1,000 of a Share of 7.25% Cumulative Preferred Stock, Series K and incorporated herein by reference.
- 10.2. Deposit Agreement dated as of October 20, 2006 among Registrant and Computershare Trust Company N.A. and the holders of depositary receipts evidencing the Depositary Shares Each Representing 1/1,000 of a share of 6.75% Cumulative Preferred Stock, Series L. Filed with Registrant's Registration Statement on Form 8-A relating to the Depositary Shares Each Representing 1/1,000 of a Share of 6.75% Cumulative Preferred Stock, Series L and incorporated herein by reference.
- 10.3. Senior Credit Agreement daed May 26, 2003, as amended by Amendment Agreements dated July 11, 2003 and December 2, 2003, by and among First Shurgard Sprl, First Shurgard Finance Sarl, First Shurgard Deutschland GmbH, Societe Generale and others. Incorporated by reference to Exhibit 10.1 filed with the Current Report on Form 8-K dated February 21, 2005 filed by Shurgard Storage Centers, Inc. ("Shurgard") (SEC File No. 0-11455).
- 10.4. Amendment and Waiver Agreement dated February 21, 2005 to the Senior Credit Agreement dated May 26, 2003, as amended as of December 2, 2003, by and among First Shurgard Sprl, First Shurgard Finance Sarl, First Shurgard Deutschland GmbH, Societe Generale and others. Incorporated by reference to Exhibit 10.2 filed with the Current Report on Form 8-K dated February 21, 2005 filed by Shurgard.
- 10.5. Credit Facility Agreement dated July 12, 2004, between Second Shurgard SPRL, Second Shurgard Finance SARL, the Royal Bank of Scotland as Mandated Lead Arranger, the Royal Bank of Scotland PLC as Facility Agent. Incorporated by reference to Exhibit 10.43 filed with the Report on Form 10-Q for the quarter ended June 30, 2004



## Edgar Filing: PUBLIC STORAGE INC /CA - Form 10-Q

filed by Shurgard.

- 10.6. Subscription Agreement dated October 11, 2004, among Self-Storage Securitization B.V., Shurgard Self Storage SCA, et al and Citigroup Global Markets Ltd. Incorporated by reference to Exhibit 10.1 filed with the Current Report on Form 8-K dated October 15, 2004 filed by Shurgard.
- 10.7. Trust Deed as of October 15, 2004, between Self-Storage Securitisation B.V. and Citicorp Trustee Company Limited. Incorporated by reference to Exhibit 10.1 filed with the Current Report on Form 8-K dated October 21, 2004 filed by Shurgard.
- 10.8. Master Framework Agreement dated as of October 15, 2004 among Self-Storage Securitisation B.V., Shurgard Self Storage SCA, Citicorp Trustee Company Limited, Citibank, N.A., Citigroup Global Markets Limited, Citibank International plc, Barclays Bank PLC and the other parties named therein. Incorporated by reference to Exhibit 10.2 filed with the Current Report on Form 8-K dated October 21, 2004 filed by Shurgard.
- 10.9. Agency Agreement dated as of October 15, 2004, among Self-Storage Securitisation B.V., Citicorp Trustee Company Limited, Citibank, N.A. and Citibank International PLC. Incorporated by reference to Exhibit 10.3 filed with the Current Report on Form 8-K dated October 21, 2004 filed by Shurgard.
- 10.10. Issuer/Borrower Facility Agreement dated as of October 15, 2004, among Shurgard Self Storage SCA, Self Storage Securitisation B.V., Citicorp Trustee Company Limited and the other parties named therein. Incorporated by reference to Exhibit 10.4 filed with the Current Report on Form 8-K dated October 21, 2004 filed by Shurgard.
- 10.11. Liquidity Facility Agreement dated as of October 15, 2004, among Self-Storage Securitisation B.V., Barclays Bank PLC, Citicorp Trustee Company Limited and Shurgard Self Storage SCA. Incorporated by reference to Exhibit 10.5 filed with the Current Report on Form 8-K dated October 21, 2004 filed by Shurgard.
- 10.12. Tax Deed of Covenant dated as of October 15, 2004, among Self-Storage Securitisation B.V., Shurgard Self Storage SCA, Citigroup Global Markets Limited, Citicorp Trustee Company Limited and the other parties named therein. Incorporated by reference to Exhibit 10.6 filed with the Current Report on Form 8-K dated October 21, 2004 filed by Shurgard.
- 11 Statement Re: Computation of Earnings per Share. Filed herewith.
- 12 Statement Re: Computation of Ratio of Earnings to Fixed Charges. Filed herewith.
- 31.1 Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer. Filed herewith.
- 31.2 Rule 13a-14(a)/15d-14(a) Certification of Chief Financial Officer. Filed herewith.
- 32 Section 1350 Certification of Chief Executive Officer and Chief Financial Officer. Filed herewith.

