

Terreno Realty Corp  
Form 10-Q  
November 03, 2014  
Table of Contents

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

**Form 10-Q**

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

**For the quarterly period ended September 30, 2014**

**OR**

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

**For the transition period from                      to**

**Commission file number 001-34603**

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

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

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

**Incorporation or Organization)**

**Identification No.)**

**101 Montgomery Street, Suite 200**

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

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

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

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

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

Large accelerated filer  Accelerated filer

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

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

The registrant had 33,094,789 shares of its common stock, \$0.01 par value per share, outstanding as of October 31, 2014.

---

**Table of Contents**

**Terreno Realty Corporation**

**Table of Contents**

**PART I. FINANCIAL INFORMATION**

|                |   |    |
|----------------|---|----|
| <b>Item 1.</b> | Financial Statements of Terreno Realty Corporation (unaudited)  |    |
|                | <u>Consolidated Balance Sheets as of September 30, 2014 and December 31, 2013</u>   | 2  |
|                | <u>Consolidated Statements of Operations and Comprehensive Income for the three and nine months ended September 30, 2014 and 2013</u> | 3  |
|                | <u>Consolidated Statement of Equity for the nine months ended September 30, 2014</u>  | 4  |
|                | <u>Consolidated Statements of Cash Flows for the nine months ended September 30, 2014 and 2013</u>                                    | 5  |
|                | <u>Condensed Notes to Consolidated Financial Statements</u>   | 6  |
| <b>Item 2.</b> | <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>  | 16 |
| <b>Item 3.</b> | <u>Quantitative and Qualitative Disclosures About Market Risk</u>   | 32 |
| <b>Item 4.</b> | <u>Controls and Procedures</u>  | 32 |

**PART II. OTHER INFORMATION**

|                 |  |    |
|-----------------|--|----|
| <b>Item 1.</b>  | <u>Legal Proceedings</u>   | 33 |
| <b>Item 1A.</b> | <u>Risk Factors</u>  | 33 |
| <b>Item 2.</b>  | <u>Unregistered Sales of Equity Securities and Use of Proceeds</u> | 33 |
| <b>Item 3.</b>  | <u>Defaults Upon Senior Securities</u>                             | 33 |
| <b>Item 4.</b>  | <u>Mine Safety Disclosures</u>                                     | 33 |
| <b>Item 5.</b>  | <u>Other Information</u>   | 33 |
| <b>Item 6.</b>  | <u>Exhibits</u>  | 33 |

|                          |    |
|--------------------------|----|
| <b><u>SIGNATURES</u></b> | 34 |
|--------------------------|----|

|                             |    |
|-----------------------------|----|
| <b><u>EXHIBIT INDEX</u></b> | 35 |
|-----------------------------|----|

**Table of Contents****Terreno Realty Corporation****Consolidated Balance Sheets****(in thousands except share and per share data)**

|   | <i>September 30, 2014</i> | <i>December 31, 2013</i> |
|---|---------------------------|--------------------------|
|   | <i>(Unaudited)</i>        |                          |
| <b>ASSETS</b>   |                           |                          |
| Investments in real estate  |                           |                          |
| Land  | \$ 348,994                | \$ 301,802               |
| Buildings and improvements  | 382,497                   | 317,944                  |
| Intangible assets   | 36,474                    | 32,093                   |
| Total investments in properties   | 767,965                   | 651,839                  |
| Accumulated depreciation and amortization   | (40,853)                  | (27,103)                 |
| Net investments in properties   | 727,112                   | 624,736                  |
| Cash and cash equivalents   | 21,115                    | 6,989                    |
| Restricted cash   | 2,975                     | 2,560                    |
| Deferred financing costs, net   | 2,432                     | 1,896                    |
| Other assets, net   | 13,158                    | 9,143                    |
| Total assets  | \$ 766,792                | \$ 645,324               |
| <b>LIABILITIES AND EQUITY</b>   |                           |                          |
| <b>Liabilities</b>  |                           |                          |
| Credit facility   | \$ 15,000                 | \$ 31,000                |
| Term loans payable  | 58,000                    | 50,000                   |
| Mortgage loans payable  | 99,336                    | 108,313                  |
| Security deposits   | 4,709                     | 3,733                    |
| Intangible liabilities, net   | 3,227                     | 3,989                    |
| Dividends payable   | 4,633                     | 3,249                    |
| Accounts payable and other liabilities  | 13,025                    | 6,205                    |
| Total liabilities   | 197,930                   | 206,489                  |
| <b>Commitments and contingencies (Note 9)</b>   |                           |                          |
| <b>Equity</b>   |                           |                          |
| <b>Stockholders' equity</b>   |                           |                          |
| Preferred stock: \$0.01 par value, 100,000,000 shares authorized, and 1,840,000 and 1,840,000 shares (liquidation preference of \$25.00 per share) issued and outstanding, respectively | 46,000                    | 46,000                   |
| Common stock: \$0.01 par value, 400,000,000 shares authorized, and 33,094,789 and 24,990,120 shares issued and outstanding, respectively  | 330                       | 249                      |
| Additional paid-in capital  | 522,532                   | 392,586                  |

Edgar Filing: Terreno Realty Corp - Form 10-Q

Retained earnings

|                           |         |         |
|---------------------------|---------|---------|
| Total stockholders equity | 568,862 | 438,835 |
|---------------------------|---------|---------|

|                              |            |            |
|------------------------------|------------|------------|
| Total liabilities and equity | \$ 766,792 | \$ 645,324 |
|------------------------------|------------|------------|

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

**Table of Contents****Terreno Realty Corporation****Consolidated Statements of Operations and Comprehensive Income**

(in thousands except share and per share data)

(Unaudited)

|   | <i>For the Three Months Ended<br/>September 30,</i> |             | <i>For the Nine Months Ended<br/>September 30,</i> |             |
|---|---|-------------|--|-------------|
|   | <i>2014</i>   | <i>2013</i> | <i>2014</i>  | <i>2013</i> |
| <b>REVENUES</b>   |   |             |  |             |
| Rental revenues   | \$ 14,013   | \$ 9,191    | \$ 39,268  | \$ 25,445   |
| Tenant expense reimbursements   | 3,701   | 2,325       | 10,860   | 6,915       |
| Total revenues  | 17,714  | 11,516      | 50,128   | 32,360      |
| <b>COSTS AND EXPENSES</b>   |   |             |  |             |
| Property operating expenses   | 4,773   | 3,289       | 13,989   | 9,141       |
| Depreciation and amortization   | 4,918   | 3,264       | 14,047   | 8,796       |
| General and administrative  | 2,836   | 1,787       | 7,654  | 6,170       |
| Acquisition costs   | 279   | 791         | 1,772  | 1,861       |
| Total costs and expenses  | 12,806  | 9,131       | 37,462   | 25,968      |
| <b>OTHER INCOME (EXPENSE)</b>   |   |             |  |             |
| Interest and other income   | 3   | 97          |  | 106         |
| Interest expense, including amortization  | (1,473)   | (1,549)     | (4,722)  | (4,610)     |
| Total other income and expenses   | (1,470)   | (1,452)     | (4,722)  | (4,504)     |
| Income from continuing operations   | 3,438   | 933         | 7,944  | 1,888       |
| Discontinued operations   |   |             |  |             |
| Income from discontinued operations   |   | 392         |  | 1,052       |
| Net income  | 3,438   | 1,325       | 7,944  | 2,940       |
| Preferred stock dividends   | (891)   | (891)       | (2,674)  | (2,674)     |
| Net and comprehensive income, net of preferred stock dividends                        | 2,547   | 434         | 5,270  | 266         |
| Allocation to participating securities  | (12)  | (2)         | (25)   |             |
| Net and comprehensive income available to common stockholders, net of preferred stock | \$ 2,535  | \$ 432      | \$ 5,245   | \$ 266      |

dividends

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

|   |    |      |    |      |    |      |    |        |
|---|----|------|----|------|----|------|----|--------|
| Income (loss) from continuing operations<br>available to common stockholders, net of<br>preferred stock dividends | \$ | 0.08 | \$ |      | \$ | 0.18 | \$ | (0.04) |
| Income from discontinued operations   |    |      |    | 0.02 |    |      |    | 0.05   |

|  |    |      |    |      |    |      |    |      |
|--|----|------|----|------|----|------|----|------|
| Net income available to common<br>stockholders, net of preferred stock dividends | \$ | 0.08 | \$ | 0.02 | \$ | 0.18 | \$ | 0.01 |
|--|----|------|----|------|----|------|----|------|

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

|  |            |            |            |            |
|--|------------|------------|------------|------------|
|  | 32,937,432 | 24,208,008 | 28,765,403 | 19,723,266 |
|--|------------|------------|------------|------------|

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

**Table of Contents**

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

|   | <b>Preferred<br/>Stock</b> | <b>Common Stock<br/>Number of<br/>Shares</b> | <b>Amount</b> | <b>Additional<br/>Paid-<br/>in Capital</b> | <b>Retained<br/>Earnings</b> | <b>Total</b> |
|---|----------------------------|--|---------------|--|------------------------------|--------------|
| Balance as of December 31, 2013                             | \$ 46,000                  | 24,990,120                                   | \$ 249        | \$ 392,586                                 | \$                           | \$ 438,835   |
| Net income  |                            |  |               |  | 7,944                        | 7,944        |
| Issuance of common stock, net of<br>issuance costs of \$352 |                            | 8,066,140                                    | 81            | 136,382                                    |                              | 136,463      |
| Repurchase of common stock                                  |                            | (12,617)                                     |               | (284)                                      |                              | (284)        |
| Issuance of restricted stock                                |                            | 51,146                                       |               |  |                              |              |
| Stock-based compensation                                    |                            |  |               | 1,099                                      |                              | 1,099        |
| Common stock dividends                                      |                            |  |               | (7,251)                                    | (5,270)                      | (12,521)     |
| Preferred stock dividends                                   |                            |  |               |  | (2,674)                      | (2,674)      |
| Balance as of September 30, 2014                            | \$ 46,000                  | 33,094,789                                   | \$ 330        | \$ 522,532                                 | \$                           | \$ 568,862   |

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



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

|  | <b>2014</b> | <b>2013</b> |
|--|-------------|-------------|
| <b>CASH FLOWS FROM OPERATING ACTIVITIES</b>                                      |             |             |
| Net income   | \$ 7,944    | \$ 2,940    |
| Adjustments to reconcile net income to net cash provided by operating activities |             |             |
| Straight-line rents  | (2,071)     | (2,422)     |
| Amortization of lease intangibles  | (782)       | (675)       |
| Depreciation and amortization  | 14,047      | 8,796       |
| Depreciation related to discontinued operations                                  |             | 101         |
| Deferred financing cost and mortgage premium amortization                        | 229         | 187         |
| Stock-based compensation   | 2,307       | 1,614       |
| Changes in assets and liabilities  |             |             |
| Other assets   | (1,927)     | (1,534)     |
| Accounts payable and other liabilities   | 3,330       | 711         |
| Net cash provided by operating activities  | 23,077      | 9,718       |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES</b>                                      |             |             |
| Restricted cash  | 48          | (150)       |
| Cash paid for property acquisitions  | (97,820)    | (110,091)   |
| Cash paid for deposits on property acquisitions                                  | (450)       | (400)       |
| Additions to buildings, improvements and leasing costs                           | (12,577)    | (6,301)     |
| Net cash used in investing activities  | (110,799)   | (116,942)   |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES</b>                                      |             |             |
| Issuance of common stock   | 136,815     | 191,475     |
| Issuance costs on issuance of common stock                                       | (352)       | (648)       |
| Repurchase of common stock   | (284)       | (160)       |
| Borrowings on credit facility  | 84,000      | 31,500      |
| Payments on credit facility  | (100,000)   | (96,929)    |
| Borrowings on term loans payable   | 8,000       | 50,000      |
| Payments on mortgage loans payable   | (11,511)    | (2,125)     |
| Payment of deferred financing costs  | (1,010)     | (721)       |
| Dividends paid to common stockholders  | (11,136)    | (6,420)     |
| Dividends paid to preferred stockholders   | (2,674)     | (2,674)     |
| Net cash provided by financing activities  | 101,848     | 163,298     |

|  |    |        |    |        |
|--|----|--------|----|--------|
| Net increase in cash and cash equivalents        |    | 14,126 |    | 56,074 |
| Cash and cash equivalents at beginning of period |    | 6,989  |    | 5,930  |
| Cash and cash equivalents at end of period       | \$ | 21,115 | \$ | 62,004 |

#### **SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION**

|   |    |         |    |         |
|---|----|---------|----|---------|
| Cash paid for interest, net of capitalized interest   | \$ | 4,639   | \$ | 4,635   |
| Supplemental disclosures of non-cash transactions     |    |         |    |         |
| Accounts payable related to capital improvements      | \$ | 4,650   | \$ | 1,378   |
| Reconciliation of cash paid for property acquisitions |    |         |    |         |
| Acquisition of properties                             | \$ | 101,617 | \$ | 111,962 |
| Assumption of mortgage loans payable                  |    | (2,764) |    |         |
| Mortgage premiums                                     |    | (43)    |    |         |
| Assumption of other assets and liabilities            |    | (990)   |    | (1,871) |
| Net cash paid for property acquisitions               | \$ | 97,820  | \$ | 110,091 |

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

**Table of Contents**

**Terreno Realty Corporation**

**Condensed Notes to Consolidated Financial Statements**

**(Unaudited)**

**Note 1. Organization**

Terreno Realty Corporation ( Terreno , and together with its subsidiaries, the Company ) acquires, owns and operates industrial real estate in six major coastal U.S. markets: Los Angeles; Northern New Jersey/New York City; San Francisco Bay Area; Seattle; Miami; and Washington, D.C./Baltimore. As of September 30, 2014, the Company owned 109 buildings aggregating approximately 7.7 million square feet.

The Company commenced operations upon completion of an initial public offering and a concurrent private placement of common stock purchased by the Company s executive management on February 16, 2010. The Company is an internally managed Maryland corporation and elected to be taxed as a real estate investment trust ( REIT ) under Sections 856 through 860 of the Internal Revenue Code of 1986, as amended (the Code ) commencing with its taxable year ended December 31, 2010.

**Note 2. Significant Accounting Policies**

**Basis of Presentation.** The accompanying unaudited interim consolidated financial statements of the Company have been prepared in accordance with accounting principles generally accepted in the United States of America ( GAAP ) for interim financial information and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, they do not include all of the information and disclosures required by GAAP for annual financial statements. In management s opinion, all adjustments (consisting of normal recurring adjustments) considered necessary for a fair presentation have been included. The interim consolidated financial statements include all of the Company s accounts and its subsidiaries and all intercompany balances and transactions have been eliminated in consolidation. The financial statements should be read in conjunction with the financial statements contained in the Company s 2013 Annual Report on Form 10-K and the notes thereto, which was filed with the Securities and Exchange Commission on February 19, 2014.

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

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

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

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

**Impairment.** Carrying values for financial reporting purposes are reviewed for impairment on a property-by-property basis whenever events or changes in circumstances indicate that the carrying value of a property may not be fully recoverable. Examples of such events or changes in circumstances may include classifying an asset to be held for sale, changing the intended hold period or when an asset remains vacant significantly longer than expected. The intended use of an asset either held for sale or held for use can significantly impact how impairment is measured. If an asset is intended to be

**Table of Contents**

held for the long-term, the recoverability is based on the undiscounted future cash flows. If the asset carrying value is not supported on an undiscounted future cash flow basis, then the asset carrying value is measured against the lower of cost or the present value of expected cash flows over the expected hold period. An impairment charge to earnings is recognized for the excess of the asset's carrying value over the lower of cost or the present values of expected cash flows over the expected hold period. If an asset is intended to be sold, impairment is determined using the estimated fair value less costs to sell. The estimation of expected future net cash flows is inherently uncertain and relies on assumptions, among other things, regarding current and future economic and market conditions and the availability of capital. The Company determines the estimated fair values based on its assumptions regarding rental rates, lease-up and holding periods, as well as sales prices. When available, current market information is used to determine capitalization and rental growth rates. If available, current comparative sales values may also be used to establish fair value. When market information is not readily available, the inputs are based on the Company's understanding of market conditions and the experience of the Company's management team. Actual results could differ significantly from the Company's estimates. The discount rates used in the fair value estimates represent a rate commensurate with the indicated holding period with a premium layered on for risk. There were no impairment charges recorded for the three and nine months ended September 30, 2014 and 2013.

**Property Acquisitions.** Upon acquisition of a property, which are accounted for as business combinations, the Company estimates the fair value of acquired tangible assets (consisting generally of land, buildings and improvements) and intangible assets and liabilities (consisting generally of the above and below-market leases and the origination value of all in-place leases). The Company determines fair values using replacement cost, estimated cash flow projections and other valuation techniques and applying appropriate discount and capitalization rates based on available market information. Mortgage loans assumed in connection with acquisitions are recorded at their fair value using current market interest rates for similar debt at the date of acquisition. Acquisition-related costs associated with business combinations are expensed as incurred.

The fair value of the tangible assets is determined by valuing the property as if it were vacant. Land values are derived from current comparative sales values, when available, or management's estimates of the fair value based on market conditions and the experience of the Company's management team. Building and improvement values are calculated as replacement cost less depreciation, or management's estimates of the fair value of these assets using discounted cash flows analyses or similar methods. The fair value of the above and below-market leases is based on the present value of the difference between the contractual amounts to be received pursuant to the acquired leases (using a discount rate that reflects the risks associated with the acquired leases) and the Company's estimate of the market lease rates measured over a period equal to the remaining term of the leases plus the term of any below-market fixed rate renewal options. The above and below-market lease values are amortized to rental revenues over the remaining initial term plus the term of any below-market fixed rate renewal options that are considered bargain renewal options of the respective leases. The total net impact to rental revenues due to the amortization of above and below-market leases was a net increase of approximately \$0.3 million and \$0.2 million, respectively, for the three months ended September 30, 2014 and 2013, and approximately \$0.8 million and \$0.7 million, respectively, for the nine months ended September 30, 2014 and 2013. The origination value of in-place leases is based on costs to execute similar leases including commissions and other related costs. The origination value of in-place leases also includes real estate taxes, insurance and an estimate of lost rental revenue at market rates during the estimated time required to lease up the property from vacant to the occupancy level at the date of acquisition. The remaining weighted average lease term related to these intangible assets and liabilities as of September 30, 2014 is 3.9 years. As of September 30, 2014 and December 31, 2013, the Company's intangible assets and liabilities consisted of the following (dollars in thousands):

**September 30, 2014**

**December 31, 2013**

|                     | <b>Gross</b> | <b>Accumulated<br/>Amortization</b> | <b>Net</b> | <b>Gross</b> | <b>Accumulated<br/>Amortization</b> | <b>Net</b> |
|---------------------|--------------|-------------------------------------|------------|--------------|-------------------------------------|------------|
| In-place leases     | \$ 32,571    | \$ (15,495)                         | \$ 17,076  | \$ 28,601    | \$ (10,886)                         | \$ 17,715  |
| Above-market leases | \$ 3,903     | \$ (2,452)                          | \$ 1,451   | \$ 3,492     | \$ (1,922)                          | \$ 1,570   |
| Below-market leases | \$ (6,397)   | \$ 3,170                            | \$ (3,227) | \$ (5,860)   | \$ 1,871                            | \$ (3,989) |

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

**Table of Contents**

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

**Discontinued Operations.** Effective January 1, 2014, the Company adopted Accounting Standards Update (ASU) 2014-08, Presentation of Financial Statements (Topic 205) and Property, Plant and Equipment (Topic 360), Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity (Note 5). Prior to January 1, 2014, the Company separately reported as discontinued operations the historical operating results attributable to properties sold or held for sale and the applicable gain or loss on the disposition of the properties. Although this application may affect the presentation of the Company's results of operations for the periods that it has already reported, there will be no effect on its previously reported consolidated financial position, net income (loss) or cash flows.

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

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

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

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

As of September 30, 2014 and December 31, 2013, approximately \$10.2 million and \$7.2 million, respectively, of straight-line rent and accounts receivable, net of allowances were included as a component of other assets in the accompanying consolidated balance sheets.

**Deferred Financing Costs.** Costs incurred in connection with financings are capitalized and amortized to interest expense using the effective interest method over the term of the related loan. Deferred financing costs in the

accompanying consolidated balance sheets are shown at cost, net of accumulated amortization of approximately \$2.4 million and \$1.9 million as of September 30, 2014 and December 31, 2013, respectively.

***Mortgage Premiums.*** Mortgage premiums represent the excess of the fair value of debt assumed over the principal value of debt assumed in connection with property acquisitions. The mortgage premiums are being amortized to interest expense over the term of the related debt instrument using the effective interest method. As of September 30, 2014 and December 31, 2013, the net unamortized mortgage premiums were approximately \$0.4 million and \$0.6 million, respectively, and were included as a component of mortgage loans payable on the accompanying consolidated balance sheets.

***Income Taxes.*** The Company elected to be taxed as a REIT under the Code and operates as such beginning with its taxable year ended December 31, 2010. To qualify as a REIT, the Company must meet certain organizational and



**Table of Contents**

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

ASC 740-10, *Income Taxes*, provides guidance for how uncertain tax positions should be recognized, measured, presented and disclosed in the financial statements. ASC 740-10 requires the evaluation of tax positions taken in the course of preparing the Company's tax returns to determine whether the tax positions are more-likely-than-not of being sustained by the applicable tax authority. Tax benefits of positions not deemed to meet the more-likely-than-not threshold are recorded as a tax expense in the current year. As of September 30, 2014 and December 31, 2013, the Company did not have any unrecognized tax benefits and does not believe that there will be any material changes in unrecognized tax positions over the next 12 months. The Company's tax returns are subject to examination by federal, state and local tax jurisdictions beginning with the 2010 calendar year.

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

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

***Fair Value of Financial Instruments.*** ASC 820, *Fair Value Measurements and Disclosures*, defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. ASC 820 also provides guidance for using fair value to measure financial assets and liabilities. ASC 820 requires disclosure of the level within the fair value hierarchy in which the fair value measurements fall, including measurements using quoted prices in active markets for identical assets or liabilities (Level 1), quoted prices for similar instruments in active markets or quoted prices for identical or similar instruments in markets that are not active (Level 2), and significant valuation assumptions that are not readily observable in the

market (Level 3).

As of September 30, 2014 and December 31, 2013, the fair values of cash and cash equivalents and accounts payable approximated their carrying values because of the short-term nature of these investments or liabilities based on Level 1 inputs. As of September 30, 2014 and December 31, 2013, based on borrowing rates available to the Company, which are Level 2 inputs, the estimated fair values of the mortgage loans payable, term loans payable and credit facility were approximately \$171.9 million and \$188.7 million, respectively.

***New Accounting Standards.*** On May 28, 2014, the Financial Accounting Standards Board ( FASB ) issued ASU 2014-09, their final standard on revenue from contracts with customers. The guidance specifically notes that lease contracts with customers are a scope exception. ASU 2014-09 outlines a single comprehensive model for entities to use in accounting for revenues arising from contracts with customers. ASU 2014-09 is effective for annual reporting periods (including interim periods), beginning after December 15, 2016, and early adoption is not permitted. The Company will adopt the guidance effective January 1, 2017 and is currently assessing the impact on its consolidated financial statements and notes to its consolidated financial statements.

**Table of Contents**

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

**Note 3. Concentration of Credit Risk**

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

As of September 30, 2014, the Company owned 37 buildings and 2.3 million square feet located in Northern New Jersey/New York City, which accounted for approximately 31.1% of its annualized base rent, which is based on contractual base rent from leases in effect as of September 30, 2014, excluding any partial or full rent abatements.

Other real estate companies compete with the Company in its real estate markets. This results in competition for tenants to occupy space. The existence of competing properties could have a material impact on the Company's ability to lease space and on the level of rent that can be achieved. The Company had no tenants that accounted for greater than 10% of total revenues for the nine months ended September 30, 2014.

**Note 4. Investments in Real Estate**

During the three months ended September 30, 2014, the Company acquired three industrial buildings containing 157,536 square feet. The total aggregate initial investment was approximately \$20.9 million, of which \$11.8 million was recorded to land, \$8.7 million to buildings and improvements, \$0.4 million to intangible assets and \$0.1 million to intangible liabilities.

During the nine months ended September 30, 2014, the Company acquired 13 industrial buildings containing 877,240 square feet, including the assumption of a mortgage loan with a total principal amount of approximately \$2.8 million with a fixed interest rate of 5.09% that matures in August 2015. The total aggregate initial investment was approximately \$101.6 million, of which \$42.1 million was recorded to land, \$54.5 million to buildings and improvements, \$5.0 million to intangible assets and \$0.5 million to intangible liabilities.

The Company recorded revenues and net income for the three months ended September 30, 2014 of approximately \$2.1 million and \$0.8 million, respectively, and recorded revenues and net income for the nine months ended September 30, 2014 of approximately \$3.5 million and \$1.4 million, respectively, related to the 2014 acquisitions.

During the three months ended September 30, 2013, the Company acquired five industrial buildings containing 249,613 square feet. The total aggregate initial investment was approximately \$37.9 million, of which \$16.1 million was recorded to land, \$19.7 million to buildings and improvements, \$2.1 million to intangible assets and \$0.1 million to intangible liabilities.

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

During the nine months ended September 30, 2013, the Company acquired 18 industrial buildings containing 1,236,263 square feet, including one redevelopment property that contains 69,500 square feet. The total aggregate initial investment was approximately \$112.0 million, of which \$50.7 million was recorded to land, \$56.4 million to buildings and improvements, \$4.9 million to intangible assets and \$0.5 million to intangible liabilities.

The Company recorded revenues and net income for the three months ended September 30, 2013 of approximately \$1.7 million and \$0.3 million, respectively, and recorded revenues and net income for the nine months ended September 30, 2013 of approximately \$2.5 million and \$0.5 million, respectively, related to the 2013 acquisitions.

The above assets and liabilities were recorded at fair value, which uses Level 3 inputs. The properties were acquired from unrelated third parties using existing cash on hand, net of assumed mortgage loans payable and borrowings under the credit facility and were accounted for as business combinations.

**Table of Contents****Pro Forma Financial Information:**

The following supplementary pro forma financial information presents the results of operations of the Company for the three and nine months ended September 30, 2014 and 2013 as if all of the Company's acquisitions during the nine months ended September 30, 2014 occurred on January 1, 2013. The following pro forma results for the three and nine months ended September 30, 2014 and 2013 have been presented for comparative purposes only and are not necessarily indicative of the results of operations that would have actually occurred had all transactions taken place on January 1, 2013, or of future results of operations (dollars in thousands, except per share data).

|   | <i>For the Three Months Ended</i> |             | <i>For the Nine Months Ended</i> |             |
|---|-----------------------------------|-------------|----------------------------------|-------------|
|   | <i>September 30,</i>              |             | <i>September 30,</i>             |             |
|   | <i>2014</i>                       | <i>2013</i> | <i>2014</i>                      | <i>2013</i> |
| Total revenues  | \$ 17,865                         | \$ 13,763   | \$ 53,254                        | \$ 39,027   |
| Net and comprehensive income available to common stockholders, net of preferred stock dividends           | 2,860                             | 1,317       | 8,238                            | 1,119       |
| Basic and diluted net income available to common stockholders per share, net of preferred stock dividends | \$ 0.09                           | \$ 0.05     | \$ 0.29                          | \$ 0.06     |

**Note 5. Discontinued Operations**

The Company separately reported as discontinued operations the historical operating results attributable to properties sold prior to January 1, 2014 and the applicable gain or loss on the disposition of the properties. Although this application may affect the presentation prior to January 1, 2014 of the Company's results of operations for the periods that it has already reported, there will be no effect on its previously reported consolidated financial position, net income (loss) or cash flows.

In April 2014, the FASB issued ASU 2014-08, Presentation of Financial Statements (Topic 205) and Property, Plant, and Equipment (Topic 360), Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity, which amends the requirements for reporting discontinued operations. Under ASU 2014-08, a disposal of a component of an entity or a group of components of an entity is required to be reported in discontinued operations if the disposal represents a strategic shift that has (or will have) a major effect on an entity's operations and financial results when the component or group of components meets the criteria to be classified as held for sale or when the component or group of components is disposed of by sale or other than by sale. In addition, this ASU requires additional disclosures about both discontinued operations and the disposal of an individually significant component of an entity that does not qualify for discontinued operations presentation in the financial statements. The Company has adopted the provisions of ASU 2014-08 beginning with the interim period beginning January 1, 2014 and will apply the provisions prospectively.

The following summarizes the condensed results of operations of the property sold in 2013 for the three and nine months ended September 30, 2014 and 2013 (dollars in thousands):

|                                     | <i>For the Three Months Ended</i> |             | <i>For the Nine Months Ended</i> |             |
|-------------------------------------|-----------------------------------|-------------|----------------------------------|-------------|
|                                     | <i>September 30,</i>              |             | <i>September 30,</i>             |             |
|                                     | <i>2014</i>                       | <i>2013</i> | <i>2014</i>                      | <i>2013</i> |
| Rental revenues                     | \$                                | \$ 413      | \$                               | \$ 1,187    |
| Tenant expense reimbursements       |                                   | 101         |                                  | 295         |
| Property operating expenses         |                                   | (122)       |                                  | (329)       |
| Depreciation and amortization       |                                   |             |                                  | (101)       |
| Income from discontinued operations | \$                                | \$ 392      | \$                               | \$ 1,052    |

**Note 6. Debt**

On May 8, 2014, the Company entered into a Third Amended and Restated Senior Credit Agreement (the Amended Facility ) with KeyBank National Association, as administrative agent and as a lender, KeyBanc Capital Markets, as a lead arranger and PNC Bank, National Association, Union Bank, N.A. and Regions Bank as lenders (collectively the Lenders ) to, among other matters, add a seven-year \$50.0 million term loan to the existing \$150.0 million facility, which included a \$100.0 million revolving credit facility and a \$50.0 million term loan. The seven-year \$50.0 million term loan maturity date

**Table of Contents**

under the Amended Facility is May 2021 and the Company has up to six months from May 8, 2014 to borrow the full \$50.0 million. The five-year \$50.0 million term loan maturity date under the Amended Facility was extended to May 2019 (previously January 2018) and the maturity date of the revolving credit facility was extended to May 2018 (previously January 2016) with one 12-month extension option exercisable by the Company, subject, among other things, to there being an absence of an event of default under the Amended Facility and to the payment of an extension fee. The aggregate amount of the Amended Facility may be increased to a total of up to \$500.0 million, subject to the approval of the administrative agent and the identification of lenders willing to make available additional amounts. Outstanding borrowings under the Amended Facility are limited to the lesser of (i) the sum of the \$100.0 million revolving credit facility, the \$50.0 million five-year term loan and the \$50.0 million seven-year term loan or (ii) 60.0% of the value of the unencumbered properties. Interest on the Amended Facility, including the five-year and seven-year term loans, is generally to be paid based upon, at the Company's option, either (i) LIBOR plus the applicable LIBOR margin or (ii) the applicable base rate which is the greatest of the administrative agent's prime rate, 0.50% above the federal funds effective rate, or thirty-day LIBOR plus the applicable LIBOR margin for LIBOR rate loans under the Amended Facility plus 1.25%. The applicable LIBOR margin will range from 1.50% to 2.05% (1.50% at September 30, 2014) for the revolving credit facility and the five-year term loan (previously 1.65% to 2.65%) and 1.75% to 2.30% (1.75% at September 30, 2014) for the seven-year term loan, depending on the ratio of the Company's outstanding consolidated indebtedness to the value of the Company's consolidated gross asset value. The Amended Facility requires quarterly payments of an annual unused facility fee in an amount equal to 0.20% or 0.25% depending on the unused portion of the Amended Facility. The Amended Facility is guaranteed by the Company and by substantially all of the current and to-be-formed subsidiaries of the borrower (a wholly-owned subsidiary of the Company) that own an unencumbered property. The Amended Facility has been modified to be unsecured by the Company's properties or by interests in the subsidiaries that hold such properties. The Amended Facility includes a series of financial and other covenants that the Company must comply with in order to borrow under the Amended Facility. As of September 30, 2014, there were \$15.0 million of borrowings outstanding on the revolving credit facility and \$50.0 million and \$8.0 million of borrowings outstanding on the five-year term loan and seven-year term loan, respectively. As of December 31, 2013, there were \$31.0 million of borrowings outstanding on the revolving credit facility and \$50.0 million of borrowings outstanding on the five-year term loan under the Amended Facility. The Company was in compliance with the covenants under the Amended Facility at September 30, 2014 and December 31, 2013.

The mortgage loans payable are collateralized by certain of the properties and require monthly interest and principal payments until maturity and are generally non-recourse. The mortgage loans mature between 2015 and 2021. As of September 30, 2014, the Company had eight mortgage loans payable totaling approximately \$99.3 million, which bear interest at a weighted average fixed annual rate of 4.4%. As of December 31, 2013, the Company had nine mortgage loans payable totaling approximately \$108.3 million, which bore interest at a weighted average fixed annual interest rate of 4.5%. As of September 30, 2014 and December 31, 2013, the total net investment book value of the properties securing the debt was \$203.3 million and \$218.0 million, respectively.

During both the three months ended September 30, 2014 and 2013, the Company capitalized approximately \$0.1 million, and approximately \$0.3 million and \$0.2 million, respectively, during the nine months ended September 30, 2014 and 2013, of interest associated with redevelopment and expansion activities.

The scheduled principal payments of the Company's debt as of September 30, 2014 were as follows (dollars in thousands):

| <b>Credit Facility</b> | <b>Term Loans</b> | <b>Total Debt</b> |
|------------------------|-------------------|-------------------|
|------------------------|-------------------|-------------------|

|                                | <b>Mortgage Loans Payable</b> |           |           |            |
|--------------------------------|-------------------------------|-----------|-----------|------------|
| 2014 (3 months)                | \$                            | \$        | \$ 708    | \$ 708     |
| 2015                           |                               |           | 24,585    | 24,585     |
| 2016                           |                               |           | 6,649     | 6,649      |
| 2017                           |                               |           | 1,916     | 1,916      |
| 2018                           | 15,000                        |           | 1,910     | 16,910     |
| Thereafter                     |                               | 58,000    | 63,153    | 121,153    |
| <b>Subtotal</b>                | 15,000                        | 58,000    | 98,921    | 171,921    |
| Unamortized net premiums       |                               |           | 415       | 415        |
| <b>Total Debt</b>              | \$ 15,000                     | \$ 58,000 | \$ 99,336 | \$ 172,336 |
| <br>                           |                               |           |           |            |
| Weighted Average Interest Rate | 1.7%                          | 1.7%      | 4.4%      | 3.3%       |



---

**Table of Contents**

**Note 7. Stockholders Equity**

The Company's authorized capital stock consists of 400,000,000 shares of common stock, \$0.01 par value per share, and 100,000,000 shares of preferred stock, \$0.01 par value per share. On February 28, 2014, the Company established an at-the-market equity offering program (the ATM Program) pursuant to which the Company may issue and sell shares of its common stock having an aggregate offering price of up to \$100,000,000 in amounts and at times to be determined by the Company from time to time. Actual sales, if any, will depend on a variety of factors to be determined by the Company from time to time, including, among others, market conditions, the trading price of the Company's common stock, determinations by the Company of the appropriate sources of funding for the Company and potential uses of funding available to the Company. The Company intends to use the net proceeds from the offering of the shares under the ATM Program, if any, for general corporate purposes, which may include future acquisitions and repayment of indebtedness, including borrowings under the Amended Facility. During the three and nine months ended September 30, 2014, the Company did not issue any shares of common stock under the ATM Program.

On May 22, 2014, the Company completed a public follow-on offering of 8,050,000 shares of its common stock at a price per share of \$17.75. The net proceeds of the follow-on offering were approximately \$136.5 million after deducting the underwriting discount and offering costs of approximately \$6.4 million. The Company used approximately \$100.0 million of the net proceeds to repay outstanding borrowings under the Amended Facility and used the remaining net proceeds to acquire industrial properties and for general business purposes. As of September 30, 2014, 33,094,789 shares of common stock were issued and outstanding, including 157,357 non-vested restricted stock awards. As of December 31, 2013, 24,990,120 shares of common stock were issued and outstanding, including 156,568 non-vested restricted stock awards.

In connection with the annual meeting of stockholders on May 9, 2014, the Company granted a total of 16,140 shares of unrestricted common stock to its independent directors under the Company's Amended and Restated 2010 Equity Incentive Plan with a grant date fair value per share of \$18.59. The grant date fair value of the unrestricted common stock was determined using the closing price of the Company's common stock on the date of the grant. The Company recognized approximately \$0.3 million in compensation costs for the nine months ended September 30, 2014 related to this issuance.

As of September 30, 2014 and December 31, 2013, 1,840,000 shares of 7.75% Series A Cumulative Redeemable Preferred Stock (the Series A Preferred Stock) were issued and outstanding. Dividends on the Series A Preferred Stock are payable when, as and if authorized by the Company's board of directors quarterly in arrears on or about the last day of March, June, September and December of each year. The Series A Preferred Stock ranks, with respect to dividend rights and rights upon the Company's liquidation, dissolution or winding-up, senior to the Company's common stock.

Generally, the Company may not redeem the Series A Preferred Stock prior to July 19, 2017, except in limited circumstances relating to the Company's ability to qualify as a REIT, and pursuant to a special optional redemption related to a specified change of control (as defined in the articles supplementary for the Series A Preferred Stock). On and after July 19, 2017, the Company may, at its option, redeem the Series A Preferred Stock, in whole or in part, at any time or from time to time, for cash at a redemption price of \$25.00 per share, plus any accrued and unpaid dividends (whether or not authorized or declared) up to but excluding the redemption date.

As of September 30, 2014, there were 1,705,000 shares of common stock authorized for issuance as restricted stock grants, unrestricted stock awards or Performance Share awards under the Company's Amended and Restated 2010 Equity Incentive Plan, of which 1,304,840 were remaining to be issued. The grant date fair value per share of restricted stock awards issued during the period from February 16, 2010 (commencement of operations) to September 30, 2014 ranged from \$14.20 to \$20.00. The grant date fair value of the restricted stock was determined

using the initial public offering price of \$20.00 for grants issued on February 16, 2010 (commencement of operations) and for all grants issued after the commencement of operations, the Company uses the closing price of the Company's common stock on the date of grant. The fair value of the restricted stock that was granted during the nine months ended September 30, 2014 was \$1.0 million and the vesting period for the restricted stock is five years. As of September 30, 2014, the Company had approximately \$2.1 million of total unrecognized compensation costs related to restricted stock issuances, which is expected to be recognized over a remaining weighted average period of approximately 3.2 years. The Company recognized compensation costs of approximately \$0.3 million and \$0.2 million for the three months ended September 30, 2014 and 2013, respectively, and approximately \$0.8 million and \$0.7 million for the nine months ended September 30, 2014 and 2013, respectively, related to the restricted stock issuances. The following is a summary of the total restricted shares granted to the Company's executive officers and employees with the related weighted average grant date fair value share prices for the nine months ended September 30, 2014.

**Table of Contents****Restricted Stock Activity:**

|  |               | <b>Weighted Average</b> |                   |
|--|---------------|-------------------------|-------------------|
|  | <b>Shares</b> | <b>Grant Date</b>       | <b>Fair Value</b> |
| Non-vested shares outstanding as of December 31, 2013  | 156,568       | \$                      | 17.43             |
| Granted  | 51,146        |                         | 18.38             |
| Forfeited  | (12,617)      |                         | 18.33             |
| Vested   | (37,740)      |                         | 18.33             |
| Non-vested shares outstanding as of September 30, 2014 | 157,357       | \$                      | 17.45             |

The following is a vesting schedule of the total non-vested shares of restricted stock outstanding as of September 30, 2014:

| <b>Non-vested Shares Vesting Schedule</b> | <b>Number of Shares</b> |
|---|-------------------------|
| 2014 (3 months)                           | 870                     |
| 2015                                      | 61,103                  |
| 2016                                      | 35,198                  |
| 2017                                      | 29,531                  |
| 2018                                      | 20,158                  |
| Thereafter                                | 10,497                  |
| <b>Total Non-vested Shares</b>            | <b>157,357</b>          |

**Long-Term Incentive Plan:**

As of September 30, 2014, there are three open performance measurement periods for the Performance Share awards: January 1, 2012 to December 31, 2014, January 1, 2013 to December 31, 2015 and January 1, 2014 to December 31, 2016. The Performance Share awards related to the performance measurement periods from February 16, 2010 to December 31, 2013 resulted in no compensation expense as the compensation committee determined that the Company's total shareholder return did not exceed the applicable metrics during the performance measurement period. The Company recorded compensation costs of approximately \$0.7 million and \$0.1 million, respectively, for the three months ended September 30, 2014 and 2013 and approximately \$1.2 million and \$0.6 million, respectively, for the nine months ended September 30, 2014 and 2013 related to the Performance Share awards.

**Dividends:**

The following table sets forth the cash dividends paid or payable per share during the nine months ended September 30, 2014:

| <b>For the Three Months Ended</b> | <b>Security</b> | <b>Dividend<br/>per Share</b> | <b>Declaration Date</b> | <b>Record Date</b> | <b>Date Paid</b> |
|-----------------------------------|-----------------|-------------------------------|-------------------------|--------------------|------------------|
|-----------------------------------|-----------------|-------------------------------|-------------------------|--------------------|------------------|

Edgar Filing: Terreno Realty Corp - Form 10-Q

|                    |                 |             |                   |                    |                    |
|--------------------|-----------------|-------------|-------------------|--------------------|--------------------|
| March 31, 2014     | Common stock    | \$ 0.130000 | February 19, 2014 | April 7, 2014      | April 21, 2014     |
| March 31, 2014     | Preferred stock | \$ 0.484375 | February 19, 2014 | March 10, 2014     | March 31, 2014     |
| June 30, 2014      | Common stock    | \$ 0.140000 | May 9, 2014       | July 7, 2014       | July 21, 2014      |
| June 30, 2014      | Preferred stock | \$ 0.484375 | May 9, 2014       | June 11, 2014      | June 30, 2014      |
| September 30, 2014 | Common stock    | \$ 0.140000 | August 8, 2014    | October 7, 2014    | October 21, 2014   |
| September 30, 2014 | Preferred stock | \$ 0.484375 | August 8, 2014    | September 12, 2014 | September 30, 2014 |

**Note 8. Net Income (Loss) Per Share**

Pursuant to ASC 260-10-45, *Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities*, unvested share-based payment awards that contain non-forfeitable rights to dividends are participating securities and are included in the computation of earnings per share pursuant to the two-class method. The two-class method of computing earnings per share allocates earnings per share for common stock and any participating securities according to dividends declared (whether paid or unpaid) and participation rights in undistributed earnings. Under the two-

**Table of Contents**

class method, earnings per common share are computed by dividing the sum of distributed earnings to common stockholders and undistributed earnings allocated to common stockholders by the weighted average number of common shares outstanding for the period. The Company's non-vested shares of restricted stock are considered participating securities since these share-based awards contain non-forfeitable rights to dividends irrespective of whether the awards ultimately vest or expire. The Company had no dilutive restricted stock awards outstanding for both the three and nine months ended September 30, 2014 and 2013.

In accordance with the Company's policies of determining whether instruments granted in share-based payment transactions are participating securities and accounting for earnings per share, the net and comprehensive income (loss) per common share is adjusted for earnings distributed through declared dividends (if any) and allocated to all participating securities (weighted average common shares outstanding and unvested restricted shares outstanding) under the two-class method. Under this method, allocations were made to 157,357 and 157,562 of weighted average unvested restricted shares outstanding for the three months ended September 30, 2014 and 2013, respectively, and 157,555 and 155,946 of weighted average unvested restricted shares outstanding for the nine months ended September 30, 2014 and 2013, respectively.

**Note 9. Commitments and Contingencies**

**Contractual Commitments.** As of November 3, 2014, the Company had six outstanding contracts with third-party sellers to acquire six industrial properties consisting of 1,018,528 square feet. There is no assurance that the Company will acquire the properties under contract because the proposed acquisitions are subject to the completion of satisfactory due diligence and various closing conditions. The following table summarizes certain information with respect to the properties the Company has under contract<sup>1</sup>:

| <b>Market</b>                     | <b>Number of Buildings</b> | <b>Square Feet</b> | <b>Purchase Price<br/>(in thousands)</b> | <b>Assumed Debt<br/>(in thousands)</b> |
|-----------------------------------|----------------------------|--------------------|--|--|
| Los Angeles                       | 1                          | 265,500            | \$ 22,899                                | \$                                     |
| Northern New Jersey/New York City | 2                          | 80,200             | 7,445                                    |  |
| San Francisco Bay Area            |                            |                    |  |  |
| Seattle                           |                            |                    |  |  |
| Miami                             | 2                          | 191,810            | 18,850                                   |  |
| Washington, D.C./Baltimore        | 6                          | 481,018            | 45,200                                   |  |
| <b>Total</b>                      | <b>11</b>                  | <b>1,018,528</b>   | <b>\$ 94,394</b>                         | <b>\$</b>                              |

<sup>1</sup> Excludes unfunded capital commitments of \$3.6 million to expand an existing 413,000 square foot facility by approximately 190,000 square feet.

As of November 3, 2014, the Company has executed three non-binding letters of intent with third-party sellers to acquire three industrial properties consisting of 634,915 square feet. The total purchase price for these industrial properties is approximately \$83.5 million. In the normal course of its business, the Company enters into non-binding letters of intent to purchase properties from third parties that may obligate the Company to make payments or perform other obligations upon the occurrence of certain events, including the execution of a purchase and sale agreement and

satisfactory completion of various due diligence matters. There can be no assurance that the Company will enter into purchase and sale agreements with respect to these properties or otherwise complete any such prospective purchases on the terms described or at all.

As of November 3, 2014, the Company has entered into a non-binding letter of intent with a third-party purchaser to sell one property located in the Washington, D.C./Baltimore market for a sales price of approximately \$11.2 million. There can be no assurance that the Company will enter into a sale agreement with respect to the property or otherwise complete any such prospective disposition on the terms described or at all.

**Note 10. Subsequent Events**

On October 3, 2014, the Company acquired one industrial building located in Renton, Washington containing 113,170 square feet for a total purchase price of approximately \$10.0 million, including the assumption of a mortgage loan with a total principal amount of approximately \$5.7 million with a fixed interest rate of 6.06% that matures in July 2016. The property was acquired from an unrelated third party using existing cash on hand, net of the assumed mortgage loan payable and borrowings under the Company's credit facility.

**Table of Contents**

On October 8, 2014, the Company acquired one industrial building located in Rahway, New Jersey containing 84,000 square feet for a total purchase price of approximately \$7.2 million. The property was acquired from an unrelated third party using existing cash on hand and borrowings under the Company's credit facility.

On October 24, 2014, the Company acquired one industrial building located in Kent, Washington containing 106,910 square feet for a total purchase price of approximately \$9.2 million. The property was acquired from an unrelated third party using existing cash on hand and borrowings under the Company's credit facility.

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

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

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

the factors included under the headings "Risk Factors" and "Management's Discussion and Analysis of Financial Condition and Results of Operations" in our Annual Report on Form 10-K for the year ended December 31, 2013, which was filed with the Securities and Exchange Commission on February 19, 2014 and in our other public filings;

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

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

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

Edgar Filing: Terreno Realty Corp - Form 10-Q

our dependence on key personnel and our reliance on third parties to property manage the majority of our industrial properties;

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

our ability to manage our growth effectively;

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

decreased rental rates or increased vacancy rates;

increased interest rates and operating costs;

declining real estate valuations and impairment charges;



**Table of Contents**

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

our ability to make distributions to our stockholders;

our failure to successfully hedge against interest rate increases;

our failure to successfully operate acquired properties;

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

uninsured or underinsured losses relating to our properties;

environmental uncertainties and risks related to natural disasters;

financial market fluctuations; and

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

**Overview**

Terreno Realty Corporation ( Terreno , and together with its subsidiaries, we , us , our , our Company , or the Company ) acquires, owns and operates industrial real estate in six major coastal U.S. markets: Los Angeles; Northern New Jersey/New York City; San Francisco Bay Area; Seattle; Miami; and Washington, D.C./Baltimore. We invest in several types of industrial real estate, including warehouse/distribution, flex (including light industrial and research and development, or R&D) and trans-shipment. We target functional buildings in infill locations that may be shared by multiple tenants and that cater to customer demand within the various submarkets in which we operate. Infill locations are geographic locations surrounded by high concentrations of already developed land and existing buildings. As of September 30, 2014, we owned a total of 109 buildings aggregating approximately 7.7 million square feet, that were approximately 93.8% leased to 233 tenants, the largest of which accounted for approximately 6.3% of our total annualized based rent. We are an internally managed Maryland corporation and elected to be taxed as a REIT under Sections 856 through 860 of the Internal Revenue Code of 1986, as amended, or the Code, commencing with our taxable year ended December 31, 2010.

The following table summarizes by market our investments in real estate as of September 30, 2014:

| Market | Number of Rentable Buildings | Rentable Square Feet | % of Occupancy Total | Annualized as of Base | % of Annualized Total Base | Weighted Average | Gross Book Value |
|--------|------------------------------|----------------------|----------------------|-----------------------|----------------------------|------------------|------------------|
|--------|------------------------------|----------------------|----------------------|-----------------------|----------------------------|------------------|------------------|

Edgar Filing: Terreno Realty Corp - Form 10-Q

|                                      |            | September 30, Rent<br>2014 (000 s) |               |              |                  | Rent Remaining (000 s)<br>Occupied Lease<br>Square Term<br>Foot (Years)<br>2 |                |            |                      |  |
|--------------------------------------|------------|------------------------------------|---------------|--------------|------------------|--|----------------|------------|----------------------|--|
| Los Angeles                          | 17         | 1,303,071                          | 17.0%         | 87.3%        | \$ 7,859         | 14.7%  | \$ 6.91        | 2.0        | \$ 145,772           |  |
| Northern New<br>Jersey/New York City | 37         | 2,250,363                          | 29.3%         | 92.1%        | 16,669           | 31.1%  | 8.04           | 3.1        | 249,184 <sup>3</sup> |  |
| San Francisco Bay Area               | 18         | 873,762                            | 11.4%         | 98.0%        | 8,289            | 15.5%  | 9.68           | 6.3        | 111,439              |  |
| Seattle                              | 8          | 684,834                            | 8.9%          | 92.5%        | 3,880            | 7.2%   | 6.13           | 3.6        | 60,004               |  |
| Miami                                | 17         | 1,248,243                          | 16.3%         | 98.3%        | 8,212            | 15.3%  | 6.69           | 2.9        | 94,383               |  |
| Washington,<br>D.C./Baltimore        | 12         | 1,315,466                          | 17.1%         | 96.8%        | 8,683            | 16.2%  | 6.82           | 5.3        | 107,183              |  |
| <b>Total/Weighted<br/>Average</b>    | <b>109</b> | <b>7,675,739</b>                   | <b>100.0%</b> | <b>93.8%</b> | <b>\$ 53,592</b> | <b>100.0%</b>  | <b>\$ 7.44</b> | <b>3.5</b> | <b>\$ 767,965</b>    |  |

<sup>1</sup> Annualized base rent is calculated as monthly base rent per the leases, excluding any partial or full rent abatements, as of September 30, 2014, multiplied by 12.

<sup>2</sup> Weighted average remaining lease term is calculated by summing the remaining lease term of each lease as of September 30, 2014, weighted by the respective square footage.

<sup>3</sup> Includes approximately \$12.2 million of expansion land, including capitalized building costs of approximately \$7.2 million, adjacent to one of our properties.

**Table of Contents**

The following table summarizes our capital expenditures incurred during the three and nine months ended September 30, 2014 and 2013 (dollars in thousands):

|   | <i>For the Three Months Ended</i> |             | <i>For the Nine Months Ended</i> |             |
|---|-----------------------------------|-------------|----------------------------------|-------------|
|   | <i>September 30,</i>              |             | <i>September 30,</i>             |             |
|   | <i>2014</i>                       | <i>2013</i> | <i>2014</i>                      | <i>2013</i> |
| Building improvements                   | \$ 5,889                          | \$ 825      | \$ 9,306                         | \$ 3,863    |
| Tenant improvements                     | 1,048                             | 802         | 3,412                            | 1,395       |
| Leasing commissions                     | 451                               | 379         | 2,654                            | 1,683       |
| Total capital expenditures <sup>1</sup> | \$ 7,388                          | \$ 2,006    | \$ 15,372                        | \$ 6,941    |

<sup>1</sup> Includes approximately \$6.4 million and \$0.7 million for the three months ended September 30, 2014 and 2013, respectively, and approximately \$12.1 million and \$3.4 million for the nine months ended September 30, 2014 and 2013, respectively, related to leasing acquired vacancy and renovation and expansion projects (stabilization capital) at seven and five properties for the three months ended September 30, 2014 and 2013, respectively, and nine and five properties for the nine months ended September 30, 2014 and 2013, respectively.

Our industrial properties are typically subject to leases on a triple net basis, in which tenants pay their proportionate share of real estate taxes, insurance and operating costs, or are subject to leases on a modified gross basis, in which tenants pay expenses over certain threshold levels. In addition, approximately 81.5% of our leased space includes fixed rental increases or Consumer Price Index-based rental increases. Lease terms typically range from three to ten years. We monitor the liquidity and creditworthiness of our tenants on an on-going basis by reviewing outstanding accounts receivable balances, and as provided under the respective lease agreements, review the tenant's financial condition periodically as appropriate. As needed, we hold discussions with the tenant's management about their business and we conduct site visits of the tenant's operations.

Our top 20 tenants based on annualized base rent as of September 30, 2014 are as follows:

|   |                                       |               |                    | <b>Annualized</b> | <b>% of</b>       |
|---|---------------------------------------|---------------|--------------------|-------------------|-------------------|
|   | <b>Tenant</b>                         | <b>Leases</b> | <b>Rentable</b>    | <b>Base</b>       | <b>Total</b>      |
|   |                                       |               | <b>Square</b>      | <b>Rent</b>       | <b>Annualized</b> |
|   |                                       |               | <b>Feet</b>        | <b>(000 \$)</b>   | <b>Base</b>       |
|   |                                       |               |                    |                   | <b>Rent</b>       |
|   |                                       |               |                    |                   |                   |
|   |                                       |               | <b>% of Total</b>  |                   |                   |
|   |                                       |               | <b>Square Feet</b> |                   |                   |
| 1 | FedEx Corporation                     | 5             | 241,783            | \$ 3,354          | 6.3%              |
| 2 | Cepheid                               | 3             | 171,707            | 2,749             | 5.1%              |
| 3 | H.D. Smith Wholesale Drug Company     | 1             | 211,418            | 2,131             | 4.0%              |
| 4 | HD Supply                             | 2             | 223,741            | 1,861             | 3.5%              |
| 5 | Home Depot                            | 1             | 413,092            | 1,846             | 3.4%              |
| 6 | United States Government              | 2             | 152,099            | 1,704             | 3.2%              |
| 7 | YRC Worldwide                         | 2             | 61,252             | 1,298             | 2.4%              |
| 8 | Miami International Freight Solutions | 1             | 192,454            | 1,139             | 2.1%              |
| 9 | Avborne Accessory Group               | 1             | 137,594            | 1,048             | 2.0%              |

Edgar Filing: Terreno Realty Corp - Form 10-Q

|    |  |    |           |       |           |       |
|----|--|----|-----------|-------|-----------|-------|
| 10 | Ace World Class                        | 1  | 161,610   | 2.1%  | 1,008     | 1.9%  |
| 11 | Northrop Grumman Systems               | 1  | 103,200   | 1.3%  | 998       | 1.8%  |
| 12 | Banah International Group <sup>2</sup> | 1  | 301,983   | 3.9%  | 906       | 1.7%  |
| 13 | New Breed Logistics, Inc.              | 2  | 123,035   | 1.6%  | 812       | 1.5%  |
| 14 | Service West Inc.                      | 1  | 129,279   | 1.7%  | 773       | 1.4%  |
| 15 | Flying Food Group                      | 1  | 69,500    | 0.9%  | 692       | 1.3%  |
| 16 | JAM N Logistics                        | 1  | 110,336   | 1.4%  | 690       | 1.3%  |
| 17 | International Paper Company            | 1  | 137,872   | 1.8%  | 673       | 1.3%  |
| 18 | Maines Paper & Food Service            | 1  | 98,745    | 1.3%  | 642       | 1.2%  |
| 19 | Wal-Mart                               | 2  | 92,800    | 1.2%  | 641       | 1.2%  |
| 20 | Vista Color Corporation                | 1  | 74,786    | 1.0%  | 618       | 1.1%  |
|    | Total                                  | 31 | 3,208,286 | 41.8% | \$ 25,583 | 47.7% |

<sup>1</sup> Annualized base rent is calculated as monthly base rent per the leases, excluding any partial or full rent abatements, as of September 30, 2014, multiplied by 12.

<sup>2</sup> Represents a month-to-month lease related to the tenant default described under the heading Recent Developments Tenant Default.

**Table of Contents**

The following table summarizes the anticipated lease expirations for leases in place at September 30, 2014, without giving effect to the exercise of unexercised renewal options or termination rights, if any, at or prior to the scheduled expirations:

| <b>Year</b>     | <b>Rentable Square Feet<sup>1</sup></b> | <b>% of Total Rentable Square Feet</b> | <b>Annualized Base Rent (000 s)<sup>1, 2</sup></b> | <b>% of Total Annualized Base Rent<sup>1</sup></b> |
|-----------------|---|--|--|--|
| 2014 (3 months) | 397,261                                 | 5.2%                                   | \$ 1,494   | 2.4%   |
| 2015            | 1,641,027                               | 21.4%                                  | 10,159   | 17.1%  |
| 2016            | 720,436                                 | 9.4%                                   | 6,070  | 10.2%  |
| 2017            | 619,175                                 | 8.1%                                   | 6,009  | 10.1%  |
| 2018            | 630,067                                 | 8.2%                                   | 6,408  | 10.8%  |
| Thereafter      | 3,192,209                               | 41.5%                                  | 29,402   | 49.4%  |
| <b>Total</b>    | <b>7,200,175</b>                        | <b>93.8%</b>                           | <b>\$ 59,542</b>                                   | <b>100.0%</b>                                      |

<sup>1</sup> Includes leases that expire on or after September 30, 2014 and month-to-month leases totaling 316,623 square feet.

<sup>2</sup> Annualized base rent is calculated as monthly base rent per the leases at expiration, excluding any partial or full rent abatements, as of September 30, 2014, multiplied by 12.

Our ability to re-lease or renew expiring space at rental rates equal to or in excess of current rental rates will impact our results of operations. As of September 30, 2014, leases representing approximately 26.6% of the total rentable square footage of our portfolio are scheduled to expire through December 31, 2015. We currently expect that, on average, the rental rates we are likely to achieve on new (re-leased) or renewed leases for our 2014 and 2015 expirations will generally be at or above the rates currently being paid for the same space. Our past performance may not be indicative of future results, and we cannot assure you that leases will be renewed or that our properties will be re-leased at all or at rental rates equal to or above the current average rental rates. Further, re-leased/renewed rental rates in a particular market may not be consistent with rental rates across our portfolio as a whole and re-leased/renewed rental rates for particular properties within a market may not be consistent with rental rates across our portfolio within a particular market, in each case due to a number of factors, including local real estate conditions, local supply and demand for industrial space, the condition of the property, the impact of leasing incentives, including free rent and tenant improvements and whether the property, or space within the property, has been redeveloped.

**Recent Developments*****Acquisition Activity***

During the three months ended September 30, 2014, we acquired three industrial buildings containing 157,536 square feet for a total purchase price of approximately \$20.8 million. The properties were acquired from unrelated third parties using existing cash on hand and borrowings under our credit facility. The following table sets forth the industrial properties we acquired during the three months ended September 30, 2014:

| <b>Property Name</b> | <b>Location</b> | <b>Acquisition Date</b> | <b>Square Feet</b> |
|----------------------|-----------------|-------------------------|--------------------|
|----------------------|-----------------|-------------------------|--------------------|

Edgar Filing: Terreno Realty Corp - Form 10-Q

|                        |            |                 | <b>Number of<br/>Buildings</b> |         | <b>Purchase Price<br/>(in thousands)</b> | <b>Stabilized<br/>Cap Rate <sup>2</sup></b> |
|------------------------|------------|-----------------|--------------------------------|---------|--|---|
| South Main II          | Carson, CA | July 18, 2014   | 1                              | 33,769  | \$ 8,500                                 | 6.0%  |
| 79th Ave South         | Kent, WA   | July 25, 2014   | 1                              | 32,160  | 2,770                                    | 6.6%  |
| Auburn 1307            | Auburn, WA | August 22, 2014 | 1                              | 91,607  | 9,530                                    | 5.6%  |
| Total/Weighted Average |            |                 | 3                              | 157,536 | \$ 20,800                                | 5.9%  |

<sup>1</sup> Excludes intangible liabilities and mortgage premiums, if any. The total aggregate investment was approximately \$20.9 million.

<sup>2</sup> Stabilized cap rates are calculated, at the time of acquisition, as annualized cash basis net operating income for the property stabilized to market occupancy (generally 95%) divided by the total acquisition cost for the property. Total acquisition cost basis for the property includes the initial purchase price, the effects of marking assumed debt to market, buyer's due diligence and closing costs, estimated near-term capital expenditures and leasing costs necessary to achieve stabilization. We define cash basis net operating income for the property as net operating income excluding straight-line rents and amortization of lease intangibles. These stabilized cap rates are subject to risks, uncertainties, and assumptions and are not guarantees of future performance, which may be affected by known and unknown risks, trends, uncertainties, and factors that are beyond our control, including risks related to our ability to meet our estimated forecasts related to stabilized cap rates and those risk factors contained in our Annual Report on Form 10-K for the year ended December 31, 2013.

**Table of Contents**

Subsequent to September 30, 2014, we acquired three industrial buildings for a total purchase price of approximately \$26.4 million, including the assumption of a mortgage loan with a total principal amount of approximately \$5.7 million with a fixed interest rate of 6.06% that matures in July 2016. The properties were acquired from unrelated third parties using existing cash on hand, net of an assumed mortgage loan payable and borrowings under our credit facility. The following table sets forth the industrial properties we acquired subsequent to September 30, 2014:

| <b>Property Name</b> | <b>Location</b> | <b>Acquisition Date</b> | <b>Number of Buildings</b> | <b>Square Feet (in thousands)</b> | <b>Purchase Price (in thousands)</b> | <b>Stabilized Cap Rate</b> |
|----------------------|-----------------|-------------------------|----------------------------|-----------------------------------|--------------------------------------|----------------------------|
| 3401 Lind            | Renton, WA      | October 3, 2014         | 1                          | 113,170                           | \$ 9,975                             | 5.5%                       |
| 900 Hart             | Rahway, NJ      | October 8, 2014         | 1                          | 84,000                            | 7,205                                | 6.1%                       |
| Kent 216th           | Kent, WA        | October 24, 2014        | 1                          | 106,910                           | 9,214                                | 5.6%                       |
| Total                |                 |                         | 3                          | 304,080                           | \$ 26,394                            | 5.7%                       |

**Public Follow-on Offering**

On May 22, 2014, we completed a public follow-on offering of 8,050,000 shares of our common stock at a price per share of \$17.75. The net proceeds of the follow-on offering were approximately \$136.5 million after deducting the underwriting discount and offering costs of approximately \$6.4 million. We used approximately \$100.0 million of the net proceeds to repay outstanding borrowings under the Amended Facility and used the remaining net proceeds to acquire industrial properties and for general business purposes.

**Establishment of ATM Program**

On February 28, 2014, we established an at-the market equity offering program (the ATM Program) pursuant to which we may issue and sell shares of our common stock having an aggregate offering price of up to \$100,000,000 in amounts and at times as we determine from time to time. Actual sales, if any, will depend on a variety of factors to be determined by our company from time to time, including, among others, market conditions, the trading price of our common stock, our determinations of the appropriate sources of funding for our company and potential uses of funding available to us. We intend to use the net proceeds from the offering of the shares under the ATM Program, if any, for general corporate purposes, which may include future acquisitions and repayment of indebtedness, including borrowings under our Amended Facility. During the three and nine months ended September 30, 2014, we did not issue any shares of common stock under the ATM Program.

**Amendment to Credit Facility and New Term Loan**

On May 8, 2014, we entered into a Third Amended and Restated Senior Credit Agreement (the Amended Facility) with KeyBank National Association, as administrative agent and as a lender, KeyBanc Capital Markets, as a lead arranger and PNC Bank, National Association, Union Bank, N.A. and Regions Bank as lenders (collectively the Lenders) to, among other matters, add a seven-year \$50.0 million term loan to the existing \$150.0 million facility, which included a \$100.0 million revolving credit facility and a \$50.0 million term loan. The seven-year \$50.0 million term loan maturity date under the Amended Facility is May 2021 and we have up to six months from May 8, 2014 to borrow the full \$50.0 million. The five-year \$50.0 million term loan maturity date under the Amended Facility was extended to May 2019 (previously January 2018) and the maturity date of the revolving credit facility was extended to May 2018 (previously January 2016) with one 12-month extension option exercisable by us, subject, among other

things, to there being an absence of an event of default under the Amended Facility and to the payment of an extension fee. The aggregate amount of the Amended Facility may be increased to a total of up to \$500.0 million, subject to the approval of the administrative agent and the identification of lenders willing to make available additional amounts. Outstanding borrowings under the Amended Facility are limited to the lesser of (i) the sum of the \$100.0 million revolving credit facility, the \$50.0 million five-year term loan and the \$50.0 million seven-year term loan or (ii) 60.0% of the value of the unencumbered properties. Interest on the Amended Facility, including the five-year and seven-year term loans, is generally to be paid based upon, at our option, either (i) LIBOR plus the applicable LIBOR margin or (ii) the applicable base rate which is the greatest of the administrative agent's prime rate, 0.50% above the federal funds effective rate, or thirty-day LIBOR plus the applicable LIBOR margin for LIBOR rate loans under



---

**Table of Contents**

the Amended Facility plus 1.25%. The applicable LIBOR margin will range from 1.50% to 2.05% (1.50% at September 30, 2014) for the revolving credit facility and the five-year term loan (previously 1.65% to 2.65%) and 1.75% to 2.30% (1.75% at September 30, 2014) for the seven-year term loan, depending on the ratio of our outstanding consolidated indebtedness to the value of our consolidated gross asset value. The Amended Facility requires quarterly payments of an annual unused facility fee in an amount equal to 0.20% or 0.25% depending on the unused portion of the Amended Facility. The Amended Facility is guaranteed by us and by substantially all of the current and to-be-formed subsidiaries of the borrower that own an unencumbered property. The Amended Facility has been modified to be unsecured by our properties or by interests in the subsidiaries that hold such properties. The Amended Facility includes a series of financial and other covenants that we must comply with in order to borrow under the Amended Facility. As of September 30, 2014, there were \$15.0 million of borrowings outstanding on the revolving credit facility and \$50.0 million and \$8.0 million of borrowings outstanding on the five-year term loan and seven-year term loan, respectively. As of December 31, 2013, there were \$31.0 million of borrowings outstanding on the revolving credit facility and \$50.0 million of borrowings outstanding on the five-year term loan, under the Amended Facility. We were in compliance with the covenants under the Amended Facility at September 30, 2014 and December 31, 2013.

***Tenant Default***

On January 29, 2013, we filed a one count eviction action against Banah International Group, Inc. ( Banah ), our tenant at 215 10th Avenue in Hialeah, FL, for failure to pay December 2012 and January 2013 rent. On February 21, 2013, the state court entered a default judgment for possession against Banah. Later that same day, Banah filed a Chapter 11 bankruptcy petition and subsequently extended the deadline to affirm or reject the lease while working on a plan of reorganization. Banah made all payments in accordance with the lease for the period from February 21, 2013 through October 31, 2014 during the bankruptcy. On December 18, 2013, Banah filed its proposed plan for reorganization which called for a successor entity (the Successor Entity ) to assume the lease, pending plan confirmation by the Bankruptcy Court. On September 9, 2014, following the failure of the Successor Entity to fulfill its obligations, the Bankruptcy Court vacated the plan and engaged a court appointed trustee to oversee the operations of Banah. On September 24, 2014, the Court approved an emergency motion by the trustee to convert the bankruptcy to Chapter 7. As a result, we currently expect that Banah will vacate the space and we will regain possession during the fourth quarter of 2014. At September 30, 2014, the lease is recorded as a month-to-month lease and revenue is recognized as cash is received.

***Dividend and Distribution Activity***

On August 8, 2014, our board of directors declared a cash dividend in the amount of \$0.14 per share of our common stock payable on October 21, 2014 to the stockholders of record as of the close of business on October 7, 2014.

On August 8, 2014, our board of directors declared a cash dividend in the amount of \$0.484375 per share of our Series A Preferred Stock payable on September 30, 2014 to the preferred stockholders of record as of the close of business on September 12, 2014.

***Contractual Commitments***

As of November 3, 2014, we had six outstanding contracts with third-party sellers to acquire six industrial properties, three non-binding letters of intent with third-party sellers to acquire three industrial properties and one outstanding non-binding letter of intent to sell one property as described under the heading Contractual Obligations in this Quarterly Report on Form 10-Q. There is no assurance that we will acquire or sell the properties under contract or non-binding letter of intent because the proposed acquisitions and disposition are subject to the completion of

satisfactory due diligence and various closing conditions, and, in addition, with respect to the properties under non-binding letter of intent, our entry into purchase and sale agreements.

**Table of Contents****Financial Condition and Results of Operations**

We derive substantially all of our revenues from rents received from tenants under existing leases on each of our properties. These revenues include fixed base rents and recoveries of certain property operating expenses that we have incurred and that we pass through to the individual tenants. Approximately 81.5% of our leased space includes fixed rental increases or Consumer Price Index-based rental increases. Lease terms typically range from three to ten years.

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

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

The analysis of our results below for the three and nine months ended September 30, 2014 and 2013 includes the changes attributable to same store properties. The same store pool for the comparison of the three and nine months ended September 30, 2014 and 2013 includes all properties that were owned and in operation as of September 30, 2014 and since January 1, 2013 and excludes properties that were either disposed of prior to or held for sale to a third party as of September 30, 2014. As of September 30, 2014, the same store pool consisted of 66 buildings aggregating approximately 4.9 million square feet. As of September 30, 2014, the non-same store properties, which we acquired or disposed of during the course of 2013 and 2014, consisted of 43 buildings aggregating approximately 2.8 million square feet. As of September 30, 2014 and 2013, the consolidated same store pool occupancy was approximately 95.1% and 91.3%, respectively.

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

**Comparison of the Three Months Ended September 30, 2014 to the Three Months Ended September 30, 2013:**

|  | <b>For the Three Months Ended September 30,</b> |              |                  |                 |
|--|---|--------------|------------------|-----------------|
|  | <b>2014</b>                                     | <b>2013</b>  | <b>\$ Change</b> | <b>% Change</b> |
|  | <b>(Dollars in thousands)</b>                   |              |                  |                 |
| <b>Rental revenues</b>                     |   |              |                  |                 |
| Same store                                 | \$ 8,311  | \$ 7,812     | \$ 499           | 6.4%            |
| 2013 and 2014 Acquisitions                 | 5,702   | 1,379        | 4,323            | 313.5%          |
| <b>Total rental revenues</b>               | <b>14,013</b>                                   | <b>9,191</b> | <b>4,822</b>     | <b>52.5%</b>    |
| <b>Tenant expense reimbursements</b>       |   |              |                  |                 |
| Same store                                 | 2,300   | 2,060        | 240              | 11.7%           |
| 2013 and 2014 Acquisitions                 | 1,401   | 265          | 1,136            | 428.7%          |
| <b>Total tenant expense reimbursements</b> | <b>3,701</b>                                    | <b>2,325</b> | <b>1,376</b>     | <b>59.2%</b>    |

Edgar Filing: Terreno Realty Corp - Form 10-Q

|  |           |          |          |         |
|--|-----------|----------|----------|---------|
| Total revenues                           | 17,714    | 11,516   | 6,198    | 53.8%   |
| Property operating expenses              |           |          |          |         |
| Same store                               | 2,763     | 2,779    | (16)     | (0.6)%  |
| 2013 and 2014 Acquisitions               | 2,010     | 510      | 1,500    | 294.1%  |
| Total property operating expenses        | 4,773     | 3,289    | 1,484    | 45.1%   |
| Net operating income <sup>1</sup>        |           |          |          |         |
| Same store                               | 7,848     | 7,093    | 755      | 10.6%   |
| 2013 and 2014 Acquisitions               | 5,093     | 1,134    | 3,959    | 349.1%  |
| Total net operating income               | \$ 12,941 | \$ 8,227 | \$ 4,714 | 57.3%   |
| Other costs and expenses                 |           |          |          |         |
| Depreciation and amortization            | 4,918     | 3,264    | 1,654    | 50.7%   |
| General and administrative               | 2,836     | 1,787    | 1,049    | 58.7%   |
| Acquisition costs                        | 279       | 791      | (512)    | (64.7)% |
| Total other costs and expenses           | 8,033     | 5,842    | 2,191    | 37.5%   |
| Other income (expense)                   |           |          |          |         |
| Interest and other income                | 3         | 97       | (94)     | (96.9)% |
| Interest expense, including amortization | (1,473)   | (1,549)  | 76       | (4.9)%  |
| Total other income and expenses          | (1,470)   | (1,452)  | (18)     | 1.2%    |
| Income from discontinued operations      |           | 392      | (392)    | n/a     |
| Net income                               | \$ 3,438  | \$ 1,325 | \$ 2,113 | 159.5%  |

**Table of Contents**

<sup>1</sup> Includes straight-line rents and amortization of lease intangibles. See *Non-GAAP Financial Measures* in this Quarterly Report on Form 10-Q for a definition and reconciliation of net operating income and same store net operating income from net income and a discussion of why we believe net operating income and same store net operating income are useful supplemental measures of our operating performance.

*Revenues.* Total revenues increased approximately \$6.2 million for the three months ended September 30, 2014 compared to the same period from the prior year due primarily to property acquisitions during 2013 and 2014 and increased occupancy in the same store pool portfolio. The increase in same store revenues is primarily related to same store consolidated occupancy at quarter end increasing to 95.1% as of September 30, 2014 as compared to 91.3% as of September 30, 2013. For the quarters ended September 30, 2014 and 2013, approximately \$0.5 million and \$0.8 million, respectively, was recorded in straight-line rental revenues related to contractual rent abatements given to certain tenants.

*Property operating expenses.* Total property operating expenses increased approximately \$1.5 million during the three months ended September 30, 2014 compared to the same period from the prior year. The increase in total property operating expenses was primarily due to an increase of approximately \$1.5 million attributable to property acquisitions during 2013 and 2014.

*Depreciation and amortization.* Depreciation and amortization increased approximately \$1.7 million during the three months ended September 30, 2014 compared to the same period from the prior year due to property acquisitions during 2013 and 2014.

*General and administrative expenses.* General and administrative expenses increased approximately \$1.0 million for the three months ended September 30, 2014 compared to the same period from the prior year due primarily to an increase in the accrued Performance Share awards of approximately \$0.6 million as compared to the prior year and increased compensation expense and professional fees as compared to the prior year period.

*Acquisition costs.* Acquisition costs decreased by approximately \$0.5 million for the three months ended September 30, 2014 compared to the same period from the prior year due to lower costs such as broker fees, legal expenses and consulting costs.

*Interest and other income.* Interest and other income decreased approximately \$0.1 million for the three months ended September 30, 2014 compared to the same period from the prior year due primarily to insurance proceeds received in 2013 in excess of expenses due to Hurricane Sandy.

*Interest expense, including amortization.* Interest expense decreased approximately \$0.1 million for the three months ended September 30, 2014 compared to the same period from the prior year due primarily to a decrease in our average outstanding borrowings.

**Comparison of the Nine Months Ended September 30, 2014 to the Nine Months Ended September 30, 2013:**

|                            | <b>For the Nine Months Ended September 30,</b> |             |                  |                 |
|----------------------------|--|-------------|------------------|-----------------|
|                            | <b>2014</b>                                    | <b>2013</b> | <b>\$ Change</b> | <b>% Change</b> |
|                            | <b>(Dollars in thousands)</b>                  |             |                  |                 |
| Rental revenues            |  |             |                  |                 |
| Same store                 | \$ 24,861                                      | \$ 23,386   | \$ 1,475         | 6.3%            |
| 2013 and 2014 Acquisitions | 14,407   | 2,059       | 12,348           | 599.7%          |

Edgar Filing: Terreno Realty Corp - Form 10-Q

|                                     |        |        |        |        |
|-------------------------------------|--------|--------|--------|--------|
| Total rental revenues               | 39,268 | 25,445 | 13,823 | 54.3%  |
| Tenant expense reimbursements       |        |        |        |        |
| Same store                          | 7,281  | 6,559  | 722    | 11.0%  |
| 2013 and 2014 Acquisitions          | 3,579  | 356    | 3,223  | 905.3% |
| Total tenant expense reimbursements | 10,860 | 6,915  | 3,945  | 57.0%  |
| Total revenues                      | 50,128 | 32,360 | 17,768 | 54.9%  |

**Table of Contents**

|  |                  |                  |                  |               |
|--|------------------|------------------|------------------|---------------|
| <b>Property operating expenses</b>       |                  |                  |                  |               |
| Same store                               | 8,718            | 8,404            | 314              | 3.7%          |
| 2013 and 2014 Acquisitions               | 5,271            | 737              | 4,534            | 615.2%        |
| <b>Total property operating expenses</b> | <b>13,989</b>    | <b>9,141</b>     | <b>4,848</b>     | <b>53.0%</b>  |
| <b>Net operating income <sup>1</sup></b> |                  |                  |                  |               |
| Same store                               | 23,424           | 21,541           | 1,883            | 8.7%          |
| 2013 and 2014 Acquisitions               | 12,715           | 1,678            | 11,037           | 657.7%        |
| <b>Total net operating income</b>        | <b>\$ 36,139</b> | <b>\$ 23,219</b> | <b>\$ 12,920</b> | <b>55.6%</b>  |
| <b>Other costs and expenses</b>          |                  |                  |                  |               |
| Depreciation and amortization            | 14,047           | 8,796            | 5,251            | 59.7%         |
| General and administrative               | 7,654            | 6,170            | 1,484            | 24.1%         |
| Acquisition costs                        | 1,772            | 1,861            | (89)             | (4.8)%        |
| <b>Total other costs and expenses</b>    | <b>23,473</b>    | <b>16,827</b>    | <b>6,646</b>     | <b>39.5%</b>  |
| <b>Other income (expense)</b>            |                  |                  |                  |               |
| Interest and other income (expense)      |                  | 106              | (106)            | n/a           |
| Interest expense, including amortization | (4,722)          | (4,610)          | (112)            | 2.4%          |
| <b>Total other income and expenses</b>   | <b>(4,722)</b>   | <b>(4,504)</b>   | <b>(218)</b>     | <b>4.8%</b>   |
| Income from discontinued operations      |                  | 1,052            | (1,052)          | n/a           |
| <b>Net income</b>                        | <b>\$ 7,944</b>  | <b>\$ 2,940</b>  | <b>\$ 5,004</b>  | <b>170.2%</b> |

<sup>1</sup> Includes straight-line rents and amortization of lease intangibles. See *Non-GAAP Financial Measures* in this Quarterly Report on Form 10-Q for a definition and reconciliation of net operating income and same store net operating income from net income and a discussion of why we believe net operating income and same store net operating income are useful supplemental measures of our operating performance.

*Revenues.* Total revenues increased approximately \$17.8 million for the nine months ended September 30, 2014 compared to the same period from the prior year due primarily to property acquisitions during 2013 and 2014 and increased occupancy in the same store pool portfolio. In addition, rent changes on new and renewed leases commenced during the nine months ended September 30, 2014 were approximately 7.3% higher as compared with the previous rental rates in that same space. The increase in same store revenues is primarily related to same store consolidated occupancy at quarter end increasing to 95.1% as of September 30, 2014 as compared to 91.3% as of September 30, 2013 and an increase in same store tenant expense reimbursement related to snow removal expense reimbursements during the nine months ended September 30, 2014 compared to the same period from the prior year. For the nine months ended September 30, 2014 and 2013, approximately \$1.2 million and \$2.0 million, respectively, was recorded in straight-line rental revenues related to contractual rent abatements given to certain tenants.

*Property operating expenses.* Total property operating expenses increased approximately \$4.8 million during the nine months ended September 30, 2014 compared to the same period from the prior year. Total same store property

operating expenses increased during the nine months ended September 30, 2014 compared to the same period from the prior year primarily due to an increase in snow removal expenses. The increase in total property operating expenses was due primarily to an increase of approximately \$4.5 million attributable to property acquisitions during 2013 and 2014.

*Depreciation and amortization.* Depreciation and amortization increased approximately \$5.3 million during the nine months ended September 30, 2014 compared to the same period from the prior year due to property acquisitions during 2013 and 2014.

*General and administrative expenses.* General and administrative expenses increased approximately \$1.5 million for the nine months ended September 30, 2014 compared to the same period from the prior year due primarily to an increase in the accrued Performance Share awards of approximately \$0.6 million as compared to the prior year and increased compensation expense and professional fees as compared to the prior year period.

*Acquisition costs.* Acquisition costs decreased by approximately \$0.1 million for the nine months ended September 30, 2014 compared to the same period from the prior year.



## **Table of Contents**

*Interest and other income.* Interest and other income decreased approximately \$0.1 million for the nine months ended September 30, 2014 compared to the same period from the prior year due primarily to insurance proceeds received in 2013 in excess of expenses due to Hurricane Sandy.

*Interest expense, including amortization.* Interest expense increased approximately \$0.1 million for the nine months ended September 30, 2014 compared to the same period from the prior year due primarily to an increase in borrowings on the Amended Facility, net of capitalized interest.

## **Liquidity and Capital Resources**

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

limit the sum of the outstanding principal amount of our consolidated indebtedness and the liquidation preference of any outstanding perpetual preferred stock to less than 40% of our total enterprise value;

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

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

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

We intend to preserve a flexible capital structure with a long-term goal to obtain an investment grade rating and be in a position to issue unsecured debt and additional perpetual preferred stock. Prior to attaining an investment grade rating, we intend to primarily utilize non-recourse debt secured by individual properties or pools of properties with a targeted maximum loan-to-value of 65% at the time of financing, or recourse bank term loans, credit facilities and perpetual preferred stock. We may also assume debt in connection with property acquisitions which may have a higher loan-to-value.

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

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

On February 28, 2014, we established an ATM Program pursuant to which we may issue and sell shares of our common stock having an aggregate offering price of up to \$100,000,000 in amounts and at times as we determine from time to time. Actual sales, if any, will depend on a variety of factors to be determined by our company from time to time, including, among others, market conditions, the trading price of our common stock, our determinations of the appropriate sources of funding for our company and potential uses of funding available to us. We intend to use the net proceeds from the offering of the shares under the ATM Program, if any, for general corporate purposes, which may include future acquisitions and repayment of indebtedness, including borrowings under our Amended Facility. During the three and nine months ended September 30, 2014, we did not issue any shares of common stock under the ATM Program.

On May 22, 2014, we completed a public follow-on offering of 8,050,000 shares of our common stock at a price per share of \$17.75. The net proceeds of the follow-on offering were approximately \$136.5 million after deducting the underwriting discount and offering costs of approximately \$6.4 million. We used approximately \$100.0 million of the net proceeds to repay outstanding borrowings under the Amended Facility and used the remaining net proceeds to acquire industrial properties and for general business purposes.

**Table of Contents**

On May 8, 2014, we entered into a Third Amended and Restated Senior Credit Agreement (the Amended Facility) with KeyBank National Association, as administrative agent and as a lender, KeyBanc Capital Markets, as a lead arranger and PNC Bank, National Association, Union Bank, N.A. and Regions Bank as lenders (collectively the Lenders) to, among other matters, add a seven-year \$50.0 million term loan to the existing \$150.0 million facility, which included a \$100.0 million revolving credit facility and a \$50.0 million term loan. The seven-year \$50.0 million term loan maturity date under the Amended Facility is May 2021 and we have up to six months from May 8, 2014 to borrow the full \$50.0 million. The five-year \$50.0 million term loan maturity date under the Amended Facility was extended to May 2019 (previously January 2018) and the maturity date of the revolving credit facility was extended to May 2018 (previously January 2016) with one 12-month extension option exercisable by us, subject, among other things, to there being an absence of an event of default under the Amended Facility and to the payment of an extension fee. The aggregate amount of the Amended Facility may be increased to a total of up to \$500.0 million, subject to the approval of the administrative agent and the identification of lenders willing to make available additional amounts. Outstanding borrowings under the Amended Facility are limited to the lesser of (i) the sum of the \$100.0 million revolving credit facility, the \$50.0 million five-year term loan and the \$50.0 million seven-year term loan or (ii) 60.0% of the value of the unencumbered properties. Interest on the Amended Facility, including the five-year and seven-year term loans, is generally to be paid based upon, at our option, either (i) LIBOR plus the applicable LIBOR margin or (ii) the applicable base rate which is the greatest of the administrative agent's prime rate, 0.50% above the federal funds effective rate, or thirty-day LIBOR plus the applicable LIBOR margin for LIBOR rate loans under the Amended Facility plus 1.25%. The applicable LIBOR margin will range from 1.50% to 2.05% (1.50% at September 30, 2014) for the revolving credit facility and the five-year term loan (previously 1.65% to 2.65%) and 1.75% to 2.30% (1.75% at September 30, 2014) for the seven-year term loan, depending on the ratio of our outstanding consolidated indebtedness to the value of our consolidated gross asset value. The Amended Facility requires quarterly payments of an annual unused facility fee in an amount equal to 0.20% or 0.25% depending on the unused portion of the Amended Facility. The Amended Facility is guaranteed by us and by substantially all of the current and to-be-formed subsidiaries of the borrower that own an unencumbered property. The Amended Facility has been modified to be unsecured by our properties or by interests in the subsidiaries that hold such properties. The Amended Facility includes a series of financial and other covenants that we must comply with in order to borrow under the Amended Facility. As of September 30, 2014, there were \$15.0 million of borrowings outstanding on the revolving credit facility and \$50.0 million and \$8.0 million of borrowings outstanding on the five-year term loan and seven-year term loan, respectively. As of December 31, 2013, there were \$31.0 million of borrowings outstanding on the revolving credit facility and \$50.0 million of borrowings outstanding on the five-year term loan, under the Amended Facility. We were in compliance with the covenants under the Amended Facility at September 30, 2014 and December 31, 2013.

As of September 30, 2014 and December 31, 2013, we had outstanding mortgage loans payable of approximately \$99.3 million and \$108.3 million, respectively, and held cash and cash equivalents totaling approximately \$21.1 million and \$7.0 million, respectively.

The following table summarizes our debt maturities, principal payments, market capitalization, capitalization ratios, Adjusted EBITDA, interest coverage, fixed charge coverage and debt ratios as of and for the nine months ended September 30, 2014 (dollars in thousands):

|                 | <b>Credit Facility</b> | <b>Term Loans</b> | <b>Mortgage Loans Payable</b> | <b>Total Debt</b> |
|-----------------|------------------------|-------------------|-------------------------------|-------------------|
| 2014 (3 months) | \$                     | \$                | \$ 708                        | \$ 708            |
| 2015            |                        |                   | 24,585                        | 24,585            |

Edgar Filing: Terreno Realty Corp - Form 10-Q

|                                |           |           |           |            |
|--------------------------------|-----------|-----------|-----------|------------|
| 2016                           |           |           | 6,649     | 6,649      |
| 2017                           |           |           | 1,916     | 1,916      |
| 2018                           | 15,000    |           | 1,910     | 16,910     |
| Thereafter                     |           | 58,000    | 63,153    | 121,153    |
| <b>Subtotal</b>                | 15,000    | 58,000    | 98,921    | 171,921    |
| Unamortized net premiums       |           |           | 415       | 415        |
| <b>Total Debt</b>              | \$ 15,000 | \$ 58,000 | \$ 99,336 | \$ 172,336 |
| Weighted Average Interest Rate | 1.7%      | 1.7%      | 4.4%      | 3.3%       |

**Table of Contents**

|  | Shares<br>Outstanding <sup>1</sup> | Market Price <sup>2</sup> | Market Value      |
|--|------------------------------------|---------------------------|-------------------|
| Common Stock   | 33,094,789                         | \$ 18.83                  | \$ 623,175        |
| Preferred Stock (\$25.00 per share liquidation preference)                 |                                    |                           | 46,000            |
| <b>Total Equity</b>  |                                    |                           | <b>669,175</b>    |
| <b>Total Market Capitalization</b>   |                                    |                           | <b>\$ 841,511</b> |
| Total Debt-to-Total Investments in Properties <sup>3</sup>                 |                                    |                           | 22.4%             |
| Total Debt-to-Total Market Capitalization <sup>4</sup>                     |                                    |                           | 20.5%             |
| Total Debt and Preferred Stock-to-Total Market Capitalization <sup>5</sup> |                                    |                           | 25.9%             |
| Floating Rate Debt as a % of Total Debt                                    |                                    |                           | 42.4%             |
| Adjusted EBITDA <sup>6</sup>   |                                    |                           | \$ 30,792         |
| Interest Coverage <sup>7</sup>   |                                    |                           | 6.5x              |
| Fixed Charge Coverage <sup>8</sup>   |                                    |                           | 4.0x              |
| Total Debt-to-Adjusted EBITDA <sup>9</sup>                                 |                                    |                           | 3.9x              |
| Total Debt and Preferred Stock-to-Adjusted EBITDA <sup>10</sup>            |                                    |                           | 4.9x              |
| Weighted Average Maturity (years)  |                                    |                           | 4.4               |

<sup>1</sup> Includes 157,357 shares of unvested restricted stock outstanding as of September 30, 2014.

<sup>2</sup> Closing price of our shares of common stock on the New York Stock Exchange on September 30, 2014 in dollars per share.

<sup>3</sup> Total debt-to-total investments in properties is calculated as total debt, including premiums, divided by total investments in properties as of September 30, 2014.

<sup>4</sup> Total debt-to-total market capitalization is calculated as total debt, including premiums, divided by total market capitalization as of September 30, 2014.

<sup>5</sup> Total debt and preferred stock-to-total market capitalization is calculated as total debt, including premiums, plus preferred stock at liquidation preference, divided by total market capitalization as of September 30, 2014.

<sup>6</sup> Earnings before interest, taxes, gains (losses) from sales of property, depreciation and amortization, acquisition costs and stock-based compensation ( Adjusted EBITDA ) for the nine months ended September 30, 2014. See Non-GAAP Financial Measures in this Quarterly Report on Form 10-Q for a reconciliation of Adjusted EBITDA from net income and a discussion of why we believe Adjusted EBITDA is a useful supplemental measure of our operating performance.

<sup>7</sup> Interest coverage is calculated as Adjusted EBITDA divided by interest expense, including amortization. See Non-GAAP Financial Measures in this Quarterly Report on Form 10-Q for a definition and reconciliation of Adjusted EBITDA from net income and a discussion of why we believe Adjusted EBITDA is a useful supplemental measure of our operating performance.

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

- <sup>8</sup> Fixed charge coverage is calculated as Adjusted EBITDA divided by interest expense, including amortization plus preferred stock dividends. See *Non-GAAP Financial Measures* in this Quarterly Report on Form 10-Q for a definition and reconciliation of Adjusted EBITDA from net income and a discussion of why we believe Adjusted EBITDA is a useful supplemental measure of our operating performance.
- <sup>9</sup> Total debt-to-Adjusted EBITDA is calculated as total debt, including premiums, divided by annualized Adjusted EBITDA. See *Non-GAAP Financial Measures* in this Quarterly Report on Form 10-Q for a definition and reconciliation of Adjusted EBITDA from net income and a discussion of why we believe Adjusted EBITDA is a useful supplemental measure of our operating performance.

**Table of Contents**

<sup>10</sup> Total debt and preferred stock-to-Adjusted EBITDA is calculated as total debt, including premiums, plus preferred stock divided by annualized Adjusted EBITDA. See Non-GAAP Financial Measures in this Quarterly Report on Form 10-Q for a definition and reconciliation of Adjusted EBITDA from net income and a discussion of why we believe Adjusted EBITDA is a useful supplemental measure of our operating performance.

The following table sets forth the cash dividends paid or payable per share during the nine months ended September 30, 2014:

| <b>For the Three Months Ended</b> | <b>Security</b> | <b>Dividend per Share</b> | <b>Declaration Date</b> | <b>Record Date</b> | <b>Date Paid</b>   |
|-----------------------------------|-----------------|---------------------------|-------------------------|--------------------|--------------------|
| March 31, 2014                    | Common stock    | \$ 0.130000               | February 19, 2014       | April 7, 2014      | April 21, 2014     |
| March 31, 2014                    | Preferred stock | \$ 0.484375               | February 19, 2014       | March 10, 2014     | March 31, 2014     |
| June 30, 2014                     | Common stock    | \$ 0.140000               | May 9, 2014             | July 7, 2014       | July 21, 2014      |
| June 30, 2014                     | Preferred stock | \$ 0.484375               | May 9, 2014             | June 11, 2014      | June 30, 2014      |
| September 30, 2014                | Common stock    | \$ 0.140000               | August 8, 2014          | October 7, 2014    | October 21, 2014   |
| September 30, 2014                | Preferred stock | \$ 0.484375               | August 8, 2014          | September 12, 2014 | September 30, 2014 |

**Sources and Uses of Cash**

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

*Cash From Operating Activities.* Net cash provided by operating activities totaled approximately \$23.1 million for the nine months ended September 30, 2014 compared to approximately \$9.7 million for the nine months ended September 30, 2013. This increase in cash provided by operating activities is attributable to additional cash flows generated from properties acquired during 2013 and 2014 and increases in same store net operating income.

*Cash From Investing Activities.* Net cash used in investing activities was \$110.8 million and \$116.9 million, respectively, for the nine months ended September 30, 2014 and 2013, which consists primarily of cash paid for property acquisitions of \$97.8 million and \$110.1 million, respectively, and additions to buildings, improvements and leasing costs of approximately \$12.6 million and \$6.3 million, respectively.

*Cash From Financing Activities.* Net cash provided by financing activities was \$101.8 million for the nine months ended September 30, 2014, which consists primarily of \$136.5 million in net common stock issuance proceeds, less net payments on the Amended Facility of \$8.0 million, payments on mortgage loans payable of \$11.5 million and approximately \$13.8 million in dividend payments. Net cash provided by financing activities was \$163.3 million for the nine months ended September 30, 2013, which consists primarily of \$190.7 million in net common stock issuance proceeds, less net payments on the Amended Facility of approximately \$15.4 million and approximately \$9.1 million in dividend payments.

**Critical Accounting Policies**

A summary of our critical accounting policies is set forth in our Annual Report on Form 10-K for the year ended December 31, 2013 and in the condensed notes to our consolidated financial statements in this Quarterly Report on Form 10-Q.

**Off-Balance Sheet Arrangements**

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



**Table of Contents****Contractual Obligations**

As of November 3, 2014, we had six outstanding contracts with third-party sellers to acquire six industrial properties. There is no assurance that we will acquire the properties under contract because the proposed acquisitions are subject to the completion of satisfactory due diligence and various closing conditions. The following table summarizes certain information with respect to the properties we have under contract:

| <b>Market</b>                     | <b>Number of Buildings</b> | <b>Square Feet</b> | <b>Purchase Price<br/>(in thousands)</b> | <b>Assumed Debt<br/>(in thousands)</b> |
|-----------------------------------|----------------------------|--------------------|--|--|
| Los Angeles                       | 1                          | 265,500            | \$ 22,899                                | \$                                     |
| Northern New Jersey/New York City | 2                          | 80,200             | 7,445                                    |  |
| San Francisco Bay Area            |                            |                    |  |  |
| Seattle                           |                            |                    |  |  |
| Miami                             | 2                          | 191,810            | 18,850                                   |  |
| Washington, D.C./Baltimore        | 6                          | 481,018            | 45,200                                   |  |
| <b>Total</b>                      | <b>11</b>                  | <b>1,018,528</b>   | <b>\$ 94,394</b>                         | <b>\$</b>                              |

As of November 3, 2014, we have executed three non-binding letters of intent with third-party sellers to acquire three industrial properties consisting of 634,915 square feet. The total purchase price for these industrial properties is approximately \$83.5 million. In the normal course of business, we enter into non-binding letters of intent to purchase properties from third parties that may obligate us to make payments or perform other obligations upon the occurrence of certain events, including the execution of a purchase and sale agreement and satisfactory completion of various due diligence matters. There can be no assurance that we will enter into purchase and sale agreements with respect to these properties or otherwise complete any such prospective purchases on the terms described or at all.

As of November 3, 2014, we have entered into a non-binding letter of intent with a third-party purchaser to sell one property located in the Washington, D.C./Baltimore market for a sales price of approximately \$11.2 million. There can be no assurance that we will enter into a sale agreement with respect to the property or otherwise complete any such prospective disposition on the terms described or at all.

The following table summarizes our contractual obligations due by period as of September 30, 2014 (dollars in thousands):

| <b>Contractual Obligations</b>    | <b>Less than 1<br/>Year</b> | <b>1-3 Years</b> | <b>3-5 Years</b> | <b>More than 5<br/>Years</b> | <b>Total</b> |
|-----------------------------------|-----------------------------|------------------|------------------|------------------------------|--------------|
| Debt                              | \$ 11,816                   | \$ 21,577        | \$ 35,796        | \$ 102,732                   | \$ 171,921   |
| Debt Interest Payments            | 4,282                       | 5,880            | 4,773            | 1,596                        | 16,531       |
| Operating lease commitments       | 238                         | 494              | 519              | 753                          | 2,004        |
| Purchase Obligations <sup>1</sup> | 94,394                      |                  |                  |                              | 94,394       |

|       |            |           |           |            |            |
|-------|------------|-----------|-----------|------------|------------|
| Total | \$ 110,730 | \$ 27,951 | \$ 41,088 | \$ 105,081 | \$ 284,850 |
|-------|------------|-----------|-----------|------------|------------|

<sup>1</sup> Excludes unfunded capital commitments of \$3.6 million to expand an existing 413,000 square foot facility by approximately 190,000 square feet.

#### **Non-GAAP Financial Measures**

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

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

**Table of Contents**

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

The following table reflects the calculation of FFO reconciled from net and comprehensive income, net of preferred stock dividends for the three and nine months ended September 30, 2014 and 2013 (dollars in thousands except per share data):

|  | <i>For the Three</i><br><i>Months Ended September 30,</i> |          |           |          | <i>For the Nine</i><br><i>Months Ended September 30,</i> |          |           |          |
|--|---|----------|-----------|----------|--|----------|-----------|----------|
|  | 2014  | 2013     | \$ Change | % Change | 2014   | 2013     | \$ Change | % Change |
| Net and comprehensive income, net of preferred stock dividends | \$ 2,547  | \$ 434   | \$ 2,113  | 486.8%   | \$ 5,270   | \$ 266   | \$ 5,004  | 1881.2%  |
| Depreciation and amortization                                  |   |          |           |          |  |          |           |          |
| Depreciation and amortization from continuing operations       | 4,918   | 3,264    | 1,654     | 50.7%    | 14,047   | 8,796    | 5,251     | 59.7%    |
| Depreciation related to discontinued operations                |   |          |           | n/a      |  | 101      | (101)     | n/a      |
| Non-real estate depreciation                                   | (26)  | (23)     | (3)       | 13.0%    | (73)   | (77)     | 4         | (5.2)%   |
| Allocation to participating securities <sup>1</sup>            | (35)  | (23)     | (12)      | 52.2%    | (101)  | (68)     | (33)      | 48.5%    |
| Funds from operations <sup>2</sup>                             | \$ 7,404  | \$ 3,652 | \$ 3,752  | 102.7%   | \$ 19,143  | \$ 9,018 | \$ 10,125 | 112.3%   |
| Basic and diluted FFO per common share                         | \$ 0.22   | \$ 0.15  | \$ 0.07   | 49.0%    | \$ 0.67  | \$ 0.46  | \$ 0.21   | 45.5%    |

|   |            |            |            |            |
|---|------------|------------|------------|------------|
| Weighted<br>average basic<br>and diluted<br>common shares | 32,937,432 | 24,208,008 | 28,765,403 | 19,723,266 |
|---|------------|------------|------------|------------|

<sup>1</sup>To be consistent with the company's policies of determining whether instruments granted in share-based payment transactions are participating securities and accounting for earnings per share, the FFO per common share is adjusted for FFO distributed through declared dividends (if any) and allocated to all participating securities (weighted average common shares outstanding and unvested restricted shares outstanding) under the two-class method. Under this method, allocations were made to 157,357 and 157,562 of weighted average unvested restricted shares outstanding for the three months ended September 30, 2014 and 2013, respectively, and to 157,555 and 155,946 of weighted average unvested restricted shares outstanding for the nine months ended September 30, 2014 and 2013, respectively.

<sup>2</sup>Includes expensed acquisition costs of approximately \$0.3 million and \$0.8 million, respectively, for the three months ended September 30, 2014 and 2013 and approximately \$1.8 million and \$1.9 million, respectively, for the nine months ended September 30, 2014 and 2013.

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

**Table of Contents**

The following table reflects the calculation of Adjusted EBITDA reconciled from net income for the three and nine months ended September 30, 2014 and 2013 (dollars in thousands):

|  | <i>For the Three<br/>Months Ended<br/>September 30,</i> |                 |                  |                 | <i>For the Nine<br/>Months Ended<br/>September 30,</i> |                  |                  |                 |
|--|---|-----------------|------------------|-----------------|--|------------------|------------------|-----------------|
|  | <b>2014</b>   | <b>2013</b>     | <b>\$ Change</b> | <b>% Change</b> | <b>2014</b>  | <b>2013</b>      | <b>\$ Change</b> | <b>% Change</b> |
| Net income   | \$ 3,438  | \$ 1,325        | \$ 2,113         | 159.5%          | \$ 7,944   | \$ 2,940         | \$ 5,004         | 170.2%          |
| Depreciation and amortization from continuing operations | 4,918   | 3,264           | 1,654            | 50.7%           | 14,047   | 8,796            | 5,251            | 59.7%           |
| Depreciation related to discontinued operations          |   |                 |                  | n/a             |  | 101              | (101)            | n/a             |
| Interest expense, including amortization                 | 1,473   | 1,549           | (76)             | (4.9)%          | 4,722  | 4,610            | 112              | 2.4%            |
| Stock-based compensation                                 | 955   | 295             | 660              | 223.7%          | 2,307  | 1,614            | 693              | 42.9%           |
| Acquisition costs  | 279   | 791             | (512)            | (64.7)%         | 1,772  | 1,861            | (89)             | (4.8)%          |
| <b>Adjusted EBITDA</b>                                   | <b>\$ 11,063</b>  | <b>\$ 7,224</b> | <b>\$ 3,839</b>  | <b>53.1%</b>    | <b>\$ 30,792</b>                                       | <b>\$ 19,922</b> | <b>\$ 10,870</b> | <b>54.6%</b>    |

We compute NOI as rental revenues, including tenant expense reimbursements, less property operating expenses. We compute same store NOI as rental revenues, including tenant expense reimbursements, less property operating expenses on a same store basis. NOI excludes depreciation, amortization, general and administrative expenses, acquisition costs and interest expense. We compute cash-basis same store NOI as same store NOI excluding straight-line rents and amortization of lease intangibles. The same store pool includes all properties that were owned as of September 30, 2014 and since January 1, 2013 and excludes properties that were either disposed of or held for sale to a third party. As of September 30, 2014, the same store pool consisted of 66 buildings aggregating approximately 4.9 million square feet. We believe that presenting NOI, same store NOI and cash-basis same store NOI provides useful information to investors regarding our operating performance of our properties because NOI excludes certain items that are not considered to be controllable in connection with the management of the property, such as depreciation, amortization, general and administrative expenses, acquisition costs and interest expense. By presenting same store NOI and cash-basis same store NOI, the operating results on a same store basis are directly comparable from period to period.

The following table reflects the calculation of NOI, same store NOI and cash-basis same store NOI reconciled from net income for the three and nine months ended September 30, 2014 and 2013 (dollars in thousands):

|            | <i>For the Three<br/>Months Ended September 30,</i> |             |                  |                 | <i>For the Nine<br/>Months Ended September 30,</i> |             |                  |                 |
|------------|---|-------------|------------------|-----------------|--|-------------|------------------|-----------------|
|            | <b>2014</b>   | <b>2013</b> | <b>\$ Change</b> | <b>% Change</b> | <b>2014</b>  | <b>2013</b> | <b>\$ Change</b> | <b>% Change</b> |
| Net income | \$ 3,438  | \$ 1,325    | \$ 2,113         | 159.5%          | \$ 7,944   | \$ 2,940    | \$ 5,004         | 170.2%          |

Edgar Filing: Terreno Realty Corp - Form 10-Q

|   |          |          |          |         |           |           |          |         |
|---|----------|----------|----------|---------|-----------|-----------|----------|---------|
| Depreciation and amortization from continuing operations                    | 4,918    | 3,264    | 1,654    | 50.7%   | 14,047    | 8,796     | 5,251    | 59.7%   |
| Income from discontinued operations   |          | (392)    | 392      | n/a     |           | (1,052)   | 1,052    | n/a     |
| General and administrative  | 2,836    | 1,787    | 1,049    | 58.7%   | 7,654     | 6,170     | 1,484    | 24.1%   |
| Acquisition costs   | 279      | 791      | (512)    | (64.7)% | 1,772     | 1,861     | (89)     | (4.8)%  |
| Total other income and expenses   | 1,470    | 1,452    | 18       | 1.2%    | 4,722     | 4,504     | 218      | 4.8%    |
| Net operating income  | 12,941   | 8,227    | 4,714    | 57.3%   | 36,139    | 23,219    | 12,920   | 55.6%   |
| Less non same store NOI   | (5,093)  | (1,134)  | (3,959)  | 349.1%  | (12,715)  | (1,678)   | (11,037) | 657.7%  |
| Same store NOI  | \$ 7,848 | \$ 7,093 | \$ 755   | 10.6%   | \$ 23,424 | \$ 21,541 | \$ 1,883 | 8.7%    |
| Less straight-line rents and amortization of lease intangibles <sup>1</sup> | (536)    | (1,055)  | 519      | (49.2)% | (1,621)   | (2,882)   | 1,261    | (43.8)% |
| Cash-basis same store NOI   | \$ 7,312 | \$ 6,038 | \$ 1,274 | 21.1%   | \$ 21,803 | \$ 18,659 | \$ 3,144 | 16.8%   |

<sup>1</sup> Includes straight-line rents and amortization of lease intangibles for the same store pool only.

**Table of Contents**

**Item 3. Quantitative and Qualitative Disclosure About Market Risk**

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

As of September 30, 2014, we had a total of \$73.0 million of borrowings outstanding under our Amended Facility, including the five and seven-year term loans. Amounts borrowed under our Amended Facility, including the term loans, bear interest at a variable rate based on LIBOR plus an applicable LIBOR margin, which interest rate was 1.65% for the revolving credit facility and the five-year term loan, and 1.90% for the seven-year term loan as of September 30, 2014. If the LIBOR rate were to fluctuate by 0.25%, interest expense would increase or decrease, depending on rate movement, future earnings and cash flows, by approximately \$182,500 annually on the total of the outstanding balance on our Amended Facility, including the term loans, as of September 30, 2014.

**Item 4. Controls and Procedures**

**Evaluation of Disclosure Controls and Procedures**

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

**Changes in Internal Control Over Financial Reporting**

There were no changes in our internal control over financial reporting during the quarter ended September 30, 2014 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

**Table of Contents**

**PART II. OTHER INFORMATION**

**Item 1. Legal Proceedings**

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

**Item 1A. Risk Factors**

There have been no material changes to the risk factors disclosed in the Company's Annual Report on Form 10-K for the year ended December 31, 2013.

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

(a) Not Applicable.

(b) Not Applicable.

(c) Not Applicable.

**Item 3. Defaults Upon Senior Securities**

None.

**Item 4. Mine Safety Disclosures**

Not Applicable.

**Item 5. Other Information**

None.

**Item 6. Exhibits**

**Exhibit**

**Number**

**Exhibit Description**

31.1\* Rule 13a-14(a)/15d-14(a) Certification dated November 3, 2014.

31.2\* Rule 13a-14(a)/15d-14(a) Certification dated November 3, 2014.



Edgar Filing: Terreno Realty Corp - Form 10-Q

- 31.3\* Rule 13a-14(a)/15d-14(a) Certification dated November 3, 2014.
- 32.1\*\* 18 U.S.C. § 1350 Certification dated November 3, 2014.
- 32.2\*\* 18 U.S.C. § 1350 Certification dated November 3, 2014.
- 32.3\*\* 18 U.S.C. § 1350 Certification dated November 3, 2014.
- 101\* The following materials from Terreno Realty Corporation's Quarterly Report on Form 10-Q for the quarter ended September 30, 2014, formatted in XBRL (eXtensible Business Reporting Language): (i) Consolidated Balance Sheets, (ii) Consolidated Statements of Operations and Comprehensive Income, (iii) Consolidated Statement of Equity, (iv) Consolidated Statements of Cash Flows and (v) Condensed Notes to Consolidated Financial Statements.

\* Filed herewith.

\*\* Furnished herewith.

Table of Contents

**SIGNATURES**

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

|                  |  |
|------------------|--|
|                  | Terreno Realty Corporation   |
| November 3, 2014 | By: /s/ W. Blake Baird<br>W. Blake Baird<br>Chairman and Chief Executive Officer |
| November 3, 2014 | By: /s/ Michael A. Coke<br>Michael A. Coke<br>President                          |
| November 3, 2014 | By: /s/ Jaime J. Cannon<br>Jaime J. Cannon<br>Chief Financial Officer            |

**Table of Contents**

**Exhibit Index**

**Exhibit**

| <b>Number</b> | <b>Exhibit Description</b>   |
|---------------|--|
| 31.1*         | Rule 13a-14(a)/15d-14(a) Certification dated November 3, 2014.   |
| 31.2*         | Rule 13a-14(a)/15d-14(a) Certification dated November 3, 2014.   |
| 31.3*         | Rule 13a-14(a)/15d-14(a) Certification dated November 3, 2014.   |
| 32.1**        | 18 U.S.C. § 1350 Certification dated November 3, 2014.   |
| 32.2**        | 18 U.S.C. § 1350 Certification dated November 3, 2014.   |
| 32.3**        | 18 U.S.C. § 1350 Certification dated November 3, 2014.   |
| 101*          | The following materials from Terreno Realty Corporation's Quarterly Report on Form 10-Q for the quarter ended September 30, 2014, formatted in XBRL (eXtensible Business Reporting Language): (i) Consolidated Balance Sheets, (ii) Consolidated Statements of Operations and Comprehensive Income, (iii) Consolidated Statement of Equity, (iv) Consolidated Statements of Cash Flows and (v) Condensed Notes to Consolidated Financial Statements. |

\* Filed herewith.

\*\* Furnished herewith.