

Terreno Realty Corp
Form 10-K
February 19, 2014
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-K

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

For the fiscal year ended December 31, 2013

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

Incorporation or Organization)
101 Montgomery Street, Suite 200

27-1262675
(I.R.S. Employer

Identification Number)

San Francisco, CA
(Address of Principal Executive Offices)

94104
(Zip Code)

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

Securities registered pursuant to Section 12(b) of the Act:

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Title of Each Class	<u>Name of Exchange on Which Registered</u>
Common Stock, \$0.01 par value per share	New York Stock Exchange
7.75% Series A Cumulative Redeemable Preferred Stock, \$0.01 par value per share	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act:

None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

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 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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

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

Aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the closing price, as reported by the New York Stock Exchange, at which the common equity was last sold, as of June 28, 2013, the last business day of the Registrant's most recently completed second fiscal quarter: \$341,815,313. (For this computation, the Registrant has excluded the market value of all shares of its common stock reported as beneficially owned by executive officers and directors of the Registrant).

The registrant had 24,990,120 shares of its common stock, \$0.01 par value per share, outstanding as of February 14, 2014.

Documents Incorporated by Reference

Part III of this Annual Report on Form 10-K incorporates by reference portions of Terreno Realty Corporation's Proxy Statement for its 2014 Annual Meeting of Stockholders, which the registrant anticipates will be filed with the Securities and Exchange Commission no later than 120 days after the end of its 2013 fiscal year pursuant to Regulation 14A.

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Terreno Realty Corporation
Annual Report on Form 10-K
for the Year Ended December 31, 2013

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FORWARD-LOOKING STATEMENTS

This Annual Report on Form 10-K 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 which do not relate solely to historical matters are intended to identify forward-looking statements. These statements are subject to risks, uncertainties, and assumptions and are not guarantees of future performance, which may be affected by known and unknown risks, trends, uncertainties, and factors that are beyond our control. Should one or more of these risks or uncertainties materialize, or should underlying assumptions prove incorrect, actual results may vary materially from those anticipated, estimated, or projected. We expressly disclaim any responsibility to update our forward-looking statements, whether as a result of new information, future events, or otherwise, except as required by law. Accordingly, investors should use caution in relying on past forward-looking statements, which are based on results and trends at the time they are made, to anticipate future results or trends.

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

the factors included in this Annual Report on Form 10-K, including those set forth under the headings Risk Factors, and Management's Discussion and Analysis of Financial Condition and Results of Operations;

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

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

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

our dependence on key personnel and our reliance on third 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;

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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 (REIT) and possible adverse changes to tax laws;

uninsured or underinsured losses relating to our properties;

environmental uncertainties and risks related to natural disasters;

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financial market fluctuations; and

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

PART I

**Item 1. Business
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 (approximately 86.4% of our total portfolio square footage as of December 31, 2013), flex (including light industrial and research and development, or R&D) (approximately 11.1%) and trans-shipment (approximately 2.5%). 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 December 31, 2013, we owned 96 buildings aggregating approximately 6.8 million square feet, which we purchased for an aggregate purchase price of approximately \$615.8 million, including the assumption of mortgage loans payable of approximately \$55.1 million, which includes mortgage premiums of approximately \$1.5 million. As of December 31, 2013, our properties were approximately 92.8% leased to 214 tenants, the largest of which accounted for approximately 7.2% of our total annualized base rent.

We are an internally managed Maryland Corporation. We were incorporated in November 2009 and on February 16, 2010, we completed our initial public offering of 8,750,000 shares of our common stock and a concurrent private placement of an aggregate of 350,000 shares of our common stock to our executive officers at a price per share of \$20.00. The net proceeds of our initial public offering were approximately \$162.8 million after deducting the full underwriting discount of approximately \$10.5 million and other offering expenses of approximately \$1.7 million. We received net proceeds of approximately \$7.0 million from our concurrent private placement.

On January 13, 2012, we completed a public follow-on offering of 4,000,000 shares of our common stock, including 93,000 shares purchased by our senior management and directors, at a price per share of \$14.25. On February 13, 2012, we sold an additional 61,853 shares of our common stock at a price per share of \$14.25 upon the exercise by the underwriters of their option to purchase additional shares. No underwriting discount or commission was paid on the shares sold to such officers and directors. The net proceeds of the offering, after deducting the underwriting discount and offering costs, were approximately \$54.7 million. We used approximately \$41.0 million of the net proceeds to repay outstanding borrowings under our revolving credit facility on January 13, 2012 and used the remainder of the net proceeds to invest in industrial properties and for general business purposes.

On July 19, 2012, we completed a public offering of 1,840,000 shares of our 7.75% Series A Cumulative Redeemable Preferred Stock (the Series A Preferred Stock), including 240,000 shares sold upon the exercise by the underwriters of their option to purchase additional shares, at a price per share of \$25.00. The net proceeds of the offering were approximately \$44.3 million after deducting the underwriting discount and other offering expenses of approximately \$1.7 million. We used the net proceeds to reduce outstanding borrowings under our revolving credit facility.

On February 19, 2013, we completed a public follow-on offering of 5,750,000 shares of our common stock at a price per share of \$16.60, including 90,325 shares that were sold in the offering to our executive and senior officers and members of our board of directors. No underwriting discount or commission was paid on the shares sold to such officers and directors. The net proceeds of the offering, after deducting the underwriting discount and offering costs, were approximately \$90.8 million. We used approximately \$65.4 million of the net proceeds to repay outstanding borrowings under our revolving credit facility and the remaining net proceeds to invest in industrial properties and for general business purposes.

On July 11, 2013, we completed a public follow-on offering of 5,750,000 shares of our common stock at a price per share of \$18.25, including 43,250 shares that were sold in the offering to our executive and senior officers and members of our board of directors. No underwriting discount or commission was paid on the shares sold to such officers and directors. The net proceeds of the offering were approximately \$99.9 million after deducting the underwriting discount and offering costs of approximately \$5.0 million. We used approximately \$6.5 million of the net proceeds to repay outstanding borrowings under our revolving credit facility and the remaining net proceeds to acquire industrial properties and for general business purposes.

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We 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.

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Our Investment Strategy

We invest in industrial properties 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 described in more detail in the table below, we invest in several types of industrial real estate, including warehouse/distribution, flex (including light industrial and 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.

Industrial Facility General Characteristics

Warehouse / distribution (approximately 86.4% of our total portfolio square footage as of December 31, 2013)

Single and multiple tenant facilities that typically serve tenants greater than 30,000 square feet of space

Generally less than 20% office space

Typical clear height from 18 feet to 36 feet

May include production/manufacturing areas

Adequate interior access via dock high and/or grade level doors

Adequate truck court for large and small truck distribution options, possibly including staging for a high volume of truck activity and/or trailer storage

Flex (including light industrial and R&D, approximately 11.1% of our total portfolio square footage as of December 31, 2013)

Single and multiple tenant facilities that typically serve tenants less than 30,000 square feet of space

Facilities generally accommodate both office and warehouse/manufacturing activities

Typically has a larger amount of office space and shallower bay depths than warehouse/distribution facilities

Adequate parking consistent with increased office use

Adequate interior access via grade level and/or dock high doors

Staging for moderate truck activity

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May include a showroom, service center, or assembly/light manufacturing component

Enhanced landscaping

Trans-shipment (approximately 2.5% of our total portfolio square footage as of December 31, 2013)

Includes truck terminals and airport on-tarmac facilities, which serve both single and multiple tenants

Typically has a high number of dock high doors, shallow bay depth and lower clear height

Staging for a high volume of truck activity and trailer storage

We selected our target markets by drawing upon the experiences of our management team investing and operating in over 50 global industrial markets located in North America, Europe and Asia and also in anticipation of trends in logistics patterns resulting from population changes, regulatory and physical constraints, potential long term increases in carbon prices and other factors. We believe that our target markets have attractive long term investment attributes. We target assets with characteristics that include, but are not limited to, the following:

Located in high population coastal markets;

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Close proximity to transportation infrastructure (such as sea ports, airports, highways and railways);

Situated in supply-constrained submarkets with barriers to new industrial development, as a result of physical and/or regulatory constraints;

Functional and flexible layout that can be modified to accommodate single and multiple tenants;

Acquisition price at a discount to the replacement cost of the property;

Potential for enhanced return through re-tenanting or operational or physical improvements; and

Opportunity for higher and better use of the property over time.

In general, we prefer to utilize local third party property managers for day-to-day property management. We believe outsourcing property management is cost effective and provides us with operational flexibility and is a source of acquisition opportunities. We currently manage one of our properties directly and may directly manage other properties in the future if we determine such direct property management is in our best interest.

We have no current intention to acquire undeveloped industrial land or to pursue ground up development. However, we may pursue redevelopment opportunities of properties that we own or acquire adjacent land to expand our existing facilities.

We expect that we will continue to acquire the significant majority of our investments as equity interests in individual properties or portfolios of properties. We may also acquire industrial properties through the acquisition of other corporations or entities that own industrial real estate. We will opportunistically target investments in debt secured by industrial real estate that would otherwise meet our investment criteria with the intention of ultimately acquiring the underlying real estate. We currently do not intend to target specific percentages of holdings of particular types of industrial properties. This expectation is based upon prevailing market conditions and may change over time in response to different prevailing market conditions.

The properties we acquire may be stabilized (fully leased) or unstabilized (have near term lease expirations or be partially or fully vacant). During the period from February 16, 2010 to December 31, 2013, we acquired 28 unstabilized properties of which 14 have been stabilized.

We may sell properties from time to time when we believe the prospective total return from a property is particularly low relative to its market value or the market value of the property is significantly greater than its estimated replacement cost. Capital from such sales will be reinvested into properties that are expected to provide better prospective returns or returned to shareholders. We have disposed of two properties since inception.

Competitive Strengths

We believe we distinguish ourselves from our competitors through the following competitive advantages:

Focused Investment Strategy. We invest exclusively in six major coastal U.S. markets and focus on infill locations. We selected our six target markets based upon the experiences of our management team's investing and operating in over 50 global industrial markets located in North America, Europe and Asia and also in anticipation of trends in logistics patterns resulting from population changes, regulatory and physical constraints, potential long term increases in carbon prices and other factors. We have no current intention to acquire undeveloped land or pursue ground up development.

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Highly Aligned Compensation Structure. We believe that executive compensation should be closely aligned with long-term stockholder value creation. As a result, all of the incentive compensation of our executive officers is based solely on our total shareholder return exceeding the total shareholder return of the MSCI U.S. REIT Index or the FTSE NAREIT Equity Industrial Index.

Commitment to Strong Corporate Governance. We are committed to strong corporate governance, as demonstrated by the following:

all members of our board of directors serve annual terms;

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we have adopted a majority voting standard in non-contested director elections;

we have opted out of two Maryland anti-takeover provisions and, in the future, we may not opt back in to these provisions without stockholder approval;

we designed our ownership limits solely to protect our status as a REIT and not for the purpose of serving as an anti-takeover device; and

we have no stockholder rights plan. In the future, we will not adopt a stockholder rights plan unless our stockholders approve in advance the adoption of such a plan or, if adopted by our board of directors, we will submit the stockholder rights plan to our stockholders for a ratification vote within 12 months of adoption or the plan will terminate.

Our Financing Strategy

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.

Our Corporate Structure

We are a Maryland corporation formed on November 6, 2009 and have been publicly held and subject to U.S. Security and Exchange Commission, or SEC, reporting obligations since 2010. We are not structured as an Umbrella Partnership Real Estate Investment Trust, or UPREIT. We currently own our properties indirectly through subsidiaries and may utilize one or more taxable REIT subsidiaries as appropriate.

Our Tax Status

We elected to be taxed as a REIT under Sections 856 through 860 of the Code commencing with our taxable year ended December 31, 2010. We believe that our organization and method of operation has enabled and will continue to enable us to meet the requirements for qualification and taxation as a REIT for federal income tax purposes. To maintain REIT status we must meet a number of organizational and operational requirements, including a requirement that we annually distribute at least 90% of our net taxable income to our stockholders, excluding net capital gains. As a REIT, we generally will not be subject to federal income tax on REIT taxable income we currently distribute to our stockholders. If we fail to qualify as a REIT in any taxable year, we will be subject to federal income tax at regular corporate rates. Even if we qualify for taxation as a REIT, we may be subject to some federal, state and local taxes on our income or property and the income of our taxable

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REIT subsidiaries, if any, will be subject to taxation at regular corporate rates. We do not currently own any taxable REIT subsidiaries but may in the future.

Competition

We believe the current market for industrial real estate acquisitions to be competitive. We compete for real property investments with pension funds and their advisors, bank and insurance company investment accounts, other public and private real estate investment companies, real estate limited partnerships, owner-users, individuals and other entities engaged in real estate

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investment activities, some of which have greater financial resources than we do. In addition, we believe the leasing of real estate to be highly competitive. We experience competition for customers from owners and managers of competing properties. As a result, we may have to provide free rental periods, incur charges for tenant improvements or offer other inducements, all of which may have an adverse impact on our results of operations.

Environmental Matters

The industrial properties that we own and will acquire are subject to various federal, state and local environmental laws. Under these laws, courts and government agencies have the authority to require us, as owner of a contaminated property, to clean up the property, even if we did not know of or were not responsible for the contamination. These laws also apply to persons who owned a property at the time it became contaminated, and therefore it is possible we could incur these costs even after we sell some of our properties. In addition to the costs of cleanup, environmental contamination can affect the value of a property and, therefore, an owner's ability to borrow using the property as collateral or to sell the property. Under applicable environmental laws, courts and government agencies also have the authority to require that a person who sent waste to a waste disposal facility, such as a landfill or an incinerator, pay for the clean-up of that facility if it becomes contaminated and threatens human health or the environment.

Furthermore, various court decisions have established that third parties may recover damages for injury caused by property contamination. For instance, a person exposed to asbestos at one of our properties may seek to recover damages if he or she suffers injury from the asbestos. Lastly, some of these environmental laws restrict the use of a property or place conditions on various activities. An example would be laws that require a business using chemicals to manage them carefully and to notify local officials that the chemicals are being used.

We could be responsible for any of the costs discussed above. The costs to clean up a contaminated property, to defend against a claim, or to comply with environmental laws could be material and could adversely affect the funds available for distribution to our stockholders. We generally obtain Phase I environmental site assessments, or ESAs, on each property prior to acquiring it. However, these ESAs may not reveal all environmental costs that might have a material adverse effect on our business, assets, results of operations or liquidity and may not identify all potential environmental liabilities.

In general, we utilize local third party property managers for day-to-day property management and will rely on these third parties to operate our industrial properties in compliance with applicable federal, state and local environmental laws in their daily operation of the respective properties and to promptly notify us of any environmental contaminations or similar issues. As a result, we may become subject to material environmental liabilities of which we are unaware. We can make no assurances that (1) future laws or regulations will not impose material environmental liabilities on us, or (2) the environmental condition of our industrial properties will not be affected by the condition of the properties in the vicinity of our industrial properties (such as the presence of leaking underground storage tanks) or by third parties unrelated to us. We were not aware of any significant or material exposures as of December 31, 2013 and 2012.

Employees

As of February 19, 2014, we have 15 employees. None of our employees is a member of any union.

Available Information

We maintain an internet website at the following address: <http://terreno.com>. The information on our website is neither part of nor incorporated by reference in this Annual Report on Form 10-K. We make available, free of charge, on or through our website certain reports and amendments to those reports that we file with or furnish to the SEC in accordance with the Exchange Act. These include our annual reports on Form 10-K, our quarterly reports on Form 10-Q, our current reports on Form 8-K and exhibits and amendments to these reports, and Section 16 filings. Our Code of Business Conduct and Ethics is also available on our website. We intend to disclose any amendments or waivers to our Code of Business Conduct and Ethics that apply to any of our executive officers on our website. We make this information available on our website free of charge as soon as reasonably practicable after we electronically file the information with, or furnish it to, the SEC. You may also obtain our reports by accessing the EDGAR database at the SEC's website at <http://www.sec.gov>.

Item 1A. Risk Factors.

The following risk factors and other information included in this Annual Report on Form 10-K should be carefully considered. The risks and uncertainties described below are not the only ones that we face. Additional risks and uncertainties not presently known to us or that we may currently deem immaterial also may impair our business operations. If any of the following risks occur, our business, financial condition,

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operating results and cash flows could be adversely affected. Investors should also refer to our quarterly reports on Form 10-Q and current reports on Form 8-K for updates to these risk factors.

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Risks Related to Our Business and Our Properties

Our long-term growth will depend upon future acquisitions of properties, and we may be unable to consummate acquisitions on advantageous terms, the acquired properties may not perform as we expect, or we may be unable to quickly and efficiently integrate our new acquisitions into our existing operations.

We intend to acquire industrial properties in our six target markets. The acquisition of properties entails various risks, including the risks that our investments may not perform as we expect, that we may be unable to quickly and efficiently integrate our new acquisitions into our existing operations and that our cost estimates for bringing an acquired property up to market standards may prove inaccurate. In addition, we cannot assure you of the availability of investment opportunities in our targeted markets at attractive pricing levels or at all. In the event that such opportunities are not available in our targeted markets as we expect, our ability to execute our business plan may be adversely affected. Further, we face significant competition for attractive investment opportunities from other well-capitalized real estate investors, including pension funds and their advisors, bank and insurance company investment accounts, other public and private real estate investment companies and REITs, real estate limited partnerships, owner-users, individuals and other entities engaged in real estate investment activities, some of which have a history of operations, greater financial resources than we do and a greater ability to borrow funds to acquire properties. This competition increases as investments in real estate become increasingly attractive relative to other forms of investment. As a result of competition, we may be unable to acquire properties as we desire or the purchase price may be significantly elevated.

In addition, we expect to finance future acquisitions through a combination of borrowings under our revolving credit facility, term loans and the use of retained cash flows, long-term debt and the issuance of common and perpetual preferred stock, which may not be available at all or on advantageous terms and which could adversely affect our cash flows. Any of the above risks could adversely affect our financial condition, results of operations, cash flows and ability to pay distributions on, and the market price of, our common stock and our preferred stock.

We may make acquisitions, which pose integration and other risks that could harm our business.

We may be required to incur debt and expenditures and issue additional shares of our common stock or preferred stock to pay for industrial properties that we acquire, which may dilute our stockholders' ownership interests and may reduce or eliminate our profitability. These acquisitions may also expose us to risks such as:

the possibility that we may not be able to successfully integrate acquired properties into our operations;

the possibility that additional capital expenditures may be required;

the possibility that senior management may be required to spend considerable time negotiating agreements and integrating acquired properties;

the possible loss or reduction in value of acquired properties;

the possibility of pre-existing undisclosed liabilities regarding acquired properties, including but not limited to environmental or asbestos liability, of which our insurance may be insufficient or for which we may be unable to secure insurance coverage;

the possibility that a concentration of our industrial properties in Los Angeles, the San Francisco Bay Area and Seattle may increase our exposure to seismic activity, especially if these industrial properties are located on or near fault zones; and

the possibility that we may not meet our estimated forecasts related to stabilized cap rates.

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We expect acquisition costs, including capital expenditures required to render industrial properties operational, to increase in the future. If our revenue does not keep pace with these potential acquisition costs, we may not be able to maintain our current or expected earnings as we absorb these additional expenses. There is no assurance we would successfully overcome these risks or any other problems encountered with these acquisitions.

If we cannot obtain additional financing, our growth will be limited.

If adverse conditions in the credit markets in particular with respect to real estate materially deteriorate, our business could be materially and adversely affected. Our long-term ability to grow through investments in industrial properties will be limited if we cannot obtain additional financing on favorable terms or at all. In the future, we will rely on debt financing, including borrowings

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under our revolving credit facility, term loans, issuances of unsecured debt securities and debt secured by individual properties, to finance our acquisition activities and for working capital. If we are unable to obtain debt financing from these or other sources, or to refinance existing indebtedness upon maturity, our financial condition and results of operations would likely be adversely affected. Market conditions may make it difficult to obtain additional financing, and we cannot assure you that we will be able to obtain additional debt or equity financing or that we will be able to obtain it on favorable terms.

In addition, to qualify as a REIT, we are required to distribute at least 90% of our taxable income (determined before the deduction for dividends paid and excluding any net capital gains) each year to our stockholders, and we generally expect to make distributions in excess of such amount. As a result, our ability to retain earnings to fund acquisitions, redevelopment and expansion, if any, or other capital expenditures will be limited. We have a \$100.0 million revolving credit facility to finance acquisitions and for working capital requirements. Terreno guarantees the obligations of the borrower (a wholly-owned subsidiary) under the revolving credit facility. The revolving credit facility matures in January 2016 and provides for one 12-month extension option exercisable by us, subject, among other things, to there being an absence of an event of default and to our payment of an extension fee. As of December 31, 2013, there were \$31.0 million of borrowings outstanding on the revolving credit facility.

The availability and timing of cash distributions is uncertain.

In 2012 and 2013, we made quarterly distributions to holders of our common stock and beginning in September 2012, to holders of our preferred stock and we intend to continue to pay regular quarterly distributions. However, we bear all expenses incurred by our operations, and the funds generated by our operations, after deducting these expenses, may not be sufficient to cover desired levels of distributions to our stockholders. In addition, our board of directors, in its discretion, may retain any portion of such cash for working capital. Our ability to make distributions to our stockholders also will depend on our levels of retained cash flows, which we intend to use as a source of investment capital. We cannot assure our stockholders that sufficient funds will be available to pay distributions. Our corporate strategy is to fund the payment of quarterly distributions to our stockholders entirely from distributable cash flows. However, we may fund our quarterly distributions to our stockholders from a combination of available cash flows, net of recurring capital expenditures, and proceeds from borrowings and property dispositions. In the event we are unable to consistently fund future quarterly distributions to our stockholders entirely from distributable cash flows the value of our shares may be negatively impacted.

We depend on key personnel.

Our success depends to a significant degree upon the contributions of certain key personnel including, but not limited to, our chairman and chief executive officer and our president, each of whom would be difficult to replace. If any of our key personnel were to cease employment with us, our operating results could suffer. Our ability to retain our senior management group or to attract suitable replacements should any members of the senior management group leave is dependent on the competitive nature of the employment market. The loss of services from key members of the management group or a limitation in their availability could adversely impact our financial condition and cash flows. Further, such a loss could be negatively perceived in the capital markets. We have not obtained and do not expect to obtain key man life insurance on any of our key personnel.

We also believe that, as we expand, our future success depends, in large part, upon our ability to hire and retain highly skilled managerial, investment, financial and operational personnel. Competition for such personnel is intense, and we cannot assure our stockholders that we will be successful in attracting and retaining such skilled personnel.

Failure of the projected improvement in industrial operating fundamentals may adversely affect our ability to execute our business plan.

A substantial part of our business plan is based on our belief that industrial operating fundamentals are expected to improve over the next several years. We cannot assure you as to whether or when industrial operating fundamentals will in fact improve or to what extent they improve. In the event conditions in the industry do not improve when and as we expect, or deteriorate, our ability to execute our business plan may be adversely affected.

Our investments are concentrated in the industrial real estate sector, and our business would be adversely affected by an economic downturn in that sector.

Our investments in real estate assets are concentrated in the industrial real estate sector. This concentration may expose us to the risk of economic downturns in this sector to a greater extent than if our business activities included a more significant portion of other sectors of the real estate industry.

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Events or occurrences that affect areas in which our properties are located may materially adversely impact our financial results.

In addition to general, regional, national and international economic conditions that may materially adversely affect our business and financial results, our operating performance will be materially adversely impacted by adverse economic conditions in the specific markets in which we operate and particularly in the markets in which we have significant concentrations of properties. Any downturn in the economy in the real estate market or any of our markets and any failure to accurately predict the timing of any economic improvement in these markets could cause our operations and our revenue and cash available for distribution, including cash available to pay distributions to our stockholders, to be materially adversely affected. As of December 31, 2013, approximately 37.5% of our buildings were located in Northern New Jersey / New York City, representing approximately 35.8% of our total annualized base rent.

We may be unable to renew leases, lease vacant space, including vacant space resulting from tenant defaults, or re-lease space as leases expire.

We cannot assure you that leases at our properties will be renewed or that such properties will be re-leased at net effective rental rates equal to or above the then current average net effective rental rates. If the rental rates for our properties decrease, our tenants do not renew their leases or we do not re-lease a significant portion of our available space, including vacant space resulting from tenant defaults, and space for which leases are scheduled to expire, our financial condition, results of operations, cash flows, cash available for distribution to stockholders, per share trading price of our common stock and preferred stock and our ability to satisfy our debt service obligations could be materially adversely affected. In addition, if we are unable to renew leases or re-lease a property, the resale value of that property could be diminished because the market value of a particular property will depend in part upon the value of the leases of such property.

We face potential adverse effects from the bankruptcies or insolvencies of tenants or from tenant defaults generally.

We are dependent on tenants for our revenues, including certain significant tenants. Moreover, certain of our properties are occupied by a single tenant, and the income produced by these properties depends on the financial stability of that tenant. The bankruptcy or insolvency of the tenants at our properties, or tenant defaults generally, may adversely affect the income produced by our properties. The tenants, particularly those that are highly leveraged, could file for bankruptcy protection or become insolvent in the future. Under bankruptcy law, a tenant cannot be evicted solely because of its bankruptcy. On the other hand, a bankrupt tenant may reject and terminate its lease with us. In such case, our claim against the bankrupt tenant for unpaid and future rent would be subject to a statutory cap that might be substantially less than the remaining rent actually owed under the lease, and, even so, our claim for unpaid rent would likely not be paid in full. This shortfall could adversely affect our cash flows and results of operations and could cause us to reduce the amount of distributions to stockholders.

A default by a tenant on its lease payments could force us to find an alternative source of revenues to pay any mortgage loan or operating expenses on the property. In the event of a tenant default, we may experience delays in enforcing our rights as landlord and may incur substantial costs, including litigation and related expenses, in protecting our investment and re-leasing our property.

Declining real estate valuations and impairment charges could adversely affect our earnings and financial condition.

We review the carrying value of our properties when circumstances, such as adverse market conditions, indicate potential impairment may exist. We base our review on an estimate of the future cash flows (excluding interest charges) expected to result from the real estate investment's use and eventual disposition. We consider factors such as future operating income, trends and prospects, as well as the effects of leasing demand, competition and other factors. If our evaluation indicates that we may be unable to recover the carrying value of a real estate investment, an impairment loss will be recorded to the extent that the carrying value exceeds the estimated fair value of the property. These losses would have a direct impact on our net income because recording an impairment loss results in an immediate negative adjustment to net income. The evaluation of anticipated cash flows is highly subjective and is based in part on assumptions regarding future occupancy, rental rates and capital requirements that could differ materially from actual results in future periods. A worsening real estate market may cause us to reevaluate the assumptions used in our impairment analysis. Impairment charges could adversely affect our financial condition, results of operations, cash available for distribution, including cash available for us to pay distributions to our stockholders and per share trading price of our common stock and preferred stock.

We utilize local third party managers for day-to-day property management for the majority of our properties.

In general, we prefer to utilize local third party managers for day-to-day property management, although we currently manage one of our properties directly and may directly manage more of our properties in the future. To the extent we utilize third party managers, our cash flows from our industrial properties may be adversely affected if our managers fail to provide quality services. In addition, our managers or their affiliates may manage, and in some cases may own, invest in or provide credit support or operating guarantees to industrial properties that

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compete with our industrial properties, which may result in conflicts of interest and decisions regarding the operation of our industrial properties that are not in our best interests.

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Our real estate redevelopment or expansion strategies may not be successful.

In connection with our business strategy, we may pursue redevelopment opportunities or construct expansions or improvements of industrial properties that we own. We will be subject to risks associated with our redevelopment, renovation and expansion activities that could adversely affect our financial condition, results of operations, cash flows and ability to pay distributions on, and the market price of, our common stock.

We may not have funding for future tenant improvements.

When a tenant at one of our properties does not renew its lease or otherwise vacates its space in one of our buildings in the future, it is likely that, in order to attract one or more new tenants, we will be required to expend funds to construct new tenant improvements in the vacated space. Although we intend to manage our cash position or financing availability to pay for any improvements required for re-leasing, we cannot assure our stockholders that we will have adequate sources of funding available to us for such purposes in the future.

Debt service obligations could adversely affect our overall operating results, may require us to sell industrial properties and could adversely affect our ability to make distributions to our stockholders and the market price of our shares of common stock and preferred stock.

Our business strategy contemplates the use of both non-recourse secured debt and unsecured debt to finance long-term growth. As of December 31, 2013, we had total debt outstanding of approximately \$189.3 million, which consisted of our revolving credit facility, our \$50.0 million term loan and mortgage loans payable. While 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 shares of preferred stock to less than 40% of our total enterprise value, our governing documents contain no limitations on the amount of debt that we may incur, and our board of directors may change our financing policy at any time without stockholder approval. Over the long-term, we also intend to maintain a fixed charge coverage ratio in excess of 2.0x and limit the principal amount of our outstanding floating rate debt to less than 20% of our total consolidated indebtedness. Our board of directors may modify or eliminate these limitations at any time without the approval of our stockholders. As a result, we may be able to incur substantial additional debt, including secured debt, in the future. Incurring debt could subject us to many risks, including the risks that: