

Public Storage, Inc.
1997 Annual Report



D r i v e n b y a V i s i o n





Public Storage, Inc. and The System

Public Storage, Inc. is a fully integrated, self-administered and self-managed real estate investment trust that primarily acquires, develops, owns and operates self-storage facilities. The Company's properties are located in 38 states. At December 31, 1997, the Company owned interests in 1,136 properties, of which 1,073 were self-storage facilities or facilities that combined both self-storage and commercial space for rent and 63 were commercial properties.

The Public Storage System is a national infrastructure operated by thousands of people. The system is designed to respond efficiently to the needs of its 550,000 customers. The system also encompasses subsidiaries operating portable self-storage, truck rentals and retail stores.

Location	Number of Properties		Net Rentable Square Feet		Number of Spaces	
	Self-Storage ⁽¹⁾	Commercial ⁽²⁾	Self-Storage ⁽¹⁾	Commercial ⁽²⁾	Self-Storage ⁽¹⁾	Commercial ⁽²⁾
Alabama	15	—	569,000	—	5,213	—
Arizona	10	4	672,000	370,000	5,571	116
Arkansas	—	1	—	90,000	—	171
California	278	31	16,615,000	3,974,000	166,000	1,390
Colorado	37	—	2,329,000	—	19,623	—
Connecticut	13	—	710,000	—	6,683	—
Delaware	4	—	229,000	—	2,532	—
Florida	98	—	5,705,000	—	56,987	—
Georgia	36	—	1,957,000	—	17,509	—
Hawaii	4	—	197,000	—	3,043	—
Illinois	65	—	4,074,000	—	41,621	—
Indiana	14	—	799,000	—	6,763	—
Kansas	15	1	881,000	62,000	6,549	40
Kentucky	4	—	213,000	—	1,755	—
Louisiana	7	—	476,000	—	4,932	—
Maryland	32	3	1,802,000	419,000	18,742	75
Massachusetts	10	—	580,000	—	5,876	—
Michigan	12	—	694,000	—	6,078	—
Minnesota	6	—	341,000	—	3,138	—
Missouri	18	—	954,000	—	8,629	—
Nebraska	1	—	46,000	—	390	—
Nevada	22	—	1,409,000	—	13,351	—
New Hampshire	2	—	123,000	—	1,041	—
New Jersey	35	—	2,018,000	—	18,915	—
New York	29	—	1,692,000	—	19,000	—
North Carolina	10	—	569,000	—	4,610	—
Ohio	27	—	1,650,000	—	13,936	—
Oklahoma	8	2	430,000	144,000	3,582	298
Oregon	25	2	1,171,000	102,000	11,413	64
Pennsylvania	18	—	1,224,000	—	12,339	—
Rhode Island	2	—	64,000	—	689	—
South Carolina	2	—	81,000	—	736	—
Tennessee	10	2	647,000	136,000	5,210	58
Texas	122	8	8,029,000	843,000	70,399	380
Utah	6	—	358,000	—	2,825	—
Virginia	33	8	2,040,000	712,000	18,714	398
Washington	36	1	2,226,000	28,000	22,526	23
Wisconsin	7	—	450,000	—	3,718	—
Totals	1,073	63	64,024,000	6,880,000	610,638	3,013

⁽¹⁾ Self-storage and properties combining self-storage and commercial space.

⁽²⁾ Primarily business parks.



Selected Financial Highlights

(In thousands, except per share data)

For the year ended December 31,	1997 ⁽¹⁾	1996 ⁽¹⁾	1995 ⁽¹⁾	1994	1993
Revenues:					
Rental income	\$ 434,008	\$ 294,426	\$ 202,134	\$ 141,845	\$ 109,203
Equity in earnings of real estate entities	17,569	22,121	3,763	764	563
Facility management fees	10,141	14,428	2,144	—	—
Interest and other income	9,126	7,976	4,509	4,587	4,914
	470,844	338,951	212,550	147,196	114,680
Expenses:					
Cost of operations	174,186	94,491	72,247	52,816	42,116
Cost of facility management	1,793	2,575	352	—	—
Depreciation and amortization	91,356	64,967	40,760	28,274	24,998
General and administrative	6,384	5,524	3,982	2,631	2,541
Interest expense	6,792	8,482	8,508	6,893	6,079
Environmental cost	—	—	2,741	—	—
Advisory fee	—	—	6,437	4,983	3,619
	280,511	176,039	135,027	95,597	79,353
Income before minority interest	190,333	162,912	77,523	51,599	35,327
Minority interest in income	(11,684)	(9,363)	(7,137)	(9,481)	(7,291)
Net income	\$ 178,649	\$ 153,549	\$ 70,386	\$ 42,118	\$ 28,036
Per Common Share⁽²⁾:					
Distributions	\$0.88	\$0.88	\$0.88	\$0.85	\$0.84
Net income – Basic	\$0.92	\$1.10	\$0.96	\$1.05	\$0.98
Net income – Diluted	\$0.91	\$1.10	\$0.95	\$1.05	\$0.98
Weighted average common shares — Basic	98,446	77,117	41,039	23,978	17,483
Weighted average common shares — Diluted	98,961	77,358	41,171	24,077	17,558
Balance Sheet Data:					
Total assets	\$3,311,645	\$2,572,152	\$1,937,461	\$ 820,309	\$ 666,133
Total debt	\$ 103,558	\$ 108,443	\$ 158,052	\$ 77,235	\$ 84,076
Minority interest	\$ 288,479	\$ 116,805	\$ 112,373	\$ 141,227	\$ 193,712
Shareholders' equity	\$2,848,960	\$2,305,437	\$1,634,503	\$ 587,786	\$ 376,066
Other Data:					
Net cash provided by operating activities	\$ 293,163	\$ 245,329	\$ 123,579	\$ 79,180	\$ 59,477
Net cash used in investing activities	\$ (408,313)	\$ (479,626)	\$ (248,672)	\$(169,590)	\$(137,429)
Net cash provided by financing activities	\$ 129,749	\$ 180,717	\$ 185,378	\$ 100,029	\$ 80,100
Funds from operations ⁽³⁾	\$ 272,234	\$ 224,476	\$ 105,199	\$ 56,143	\$ 35,830

1. During 1997, 1996 and 1995 the Company completed several significant business combinations and equity transactions. See Notes 3 and 10 to the Company's consolidated financial statements.
2. The net income per share amounts prior to 1997 have been restated as required to comply with Statement of Financial Accounting Standards No. 128, *Earnings Per Share*. For further discussion of net income per share and the impact of Statement No. 128, see Note 2 to the Company's consolidated financial statements.
3. Funds from operations ("FFO"), means net income (loss) (computed in accordance with GAAP) before (i) gain (loss) on early extinguishment of debt, (ii) minority interest in income and (iii) gain (loss) on disposition of real estate, adjusted as follows: (i) plus depreciation and amortization (including the Company's pro-rata share of depreciation and amortization of unconsolidated equity interests and amortization of assets acquired in the PSMI Merger, including property management agreements and excess purchase cost over net assets acquired), and (ii) less FFO attributable to minority interest. FFO is a supplemental performance measure for equity REITs as defined by the National Association of Real Estate Investment Trusts, Inc. ("NAREIT"). The NAREIT definition does not specifically address the treatment of minority interest in the determination of FFO or the treatment of the amortization of property management agreements and excess purchase cost over net assets acquired. In the case of the Company, FFO represents amounts attributable to its shareholders after deducting amounts attributable to the minority interests and before deductions for the amortization of property management agreements and excess purchase cost over net assets acquired. FFO is presented because many analysts consider FFO to be one measure of the performance of the Company and it is used in certain aspects of the terms of the Class B Common Stock. FFO does not take into consideration scheduled principal payments on debt, capital improvements distributions and other obligations of the Company. Accordingly, FFO is not a substitute for the Company's cash flow or net income as a measure of the Company's liquidity or operating performance or ability to pay distributions.

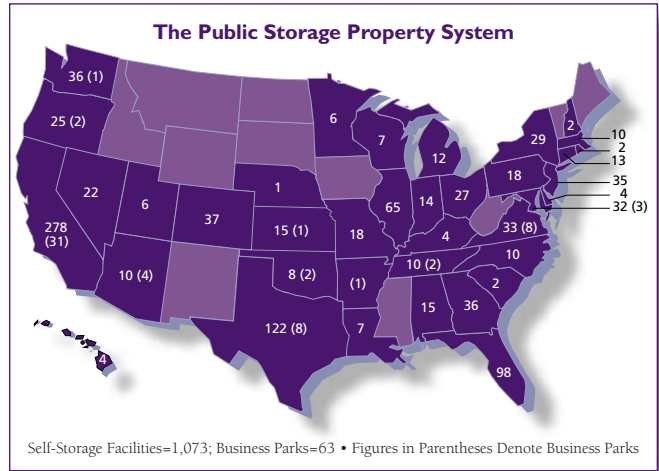


To Our Shareholders

Self-storage companies come in different sizes. The vision required to lead a local or regional business is totally different than the vision required at the national level. Public Storage became a nationwide enterprise by implementing a powerful vision. The vision is to be *The First Choice*.

To us, being *The First Choice* means that customers considering self-storage turn to us first, want us to meet their storage needs. One of our goals is to build value in our reputation as well as in our trade name. We believe we have a reputation for innovation and flexibility, helping us attract quality personnel, reflected in our employees throughout our Company. Furthermore, to the investment community being *The First Choice* means we are first among our self-storage real estate investment trust competitors. One of the nation's leading financial investment firms recently selected our Company as its Top REIT Pick for 1998.

Our vision of being *The First Choice* makes customer satisfaction a priority. We seek to create a desire in our customers to use our services and to tell their friends about us. We market our business through customer loyalty. Word-of-mouth advertising is often recognized as the best form of advertising available, a by-product of striving for customer satisfaction all the time. A vision is inconsequential without clear, achievable strategies to realize it. Five distinct performance strategies energize our vision: Leadership, low long-term capital costs, low self-storage operating costs, diversified operations and successful risk management.

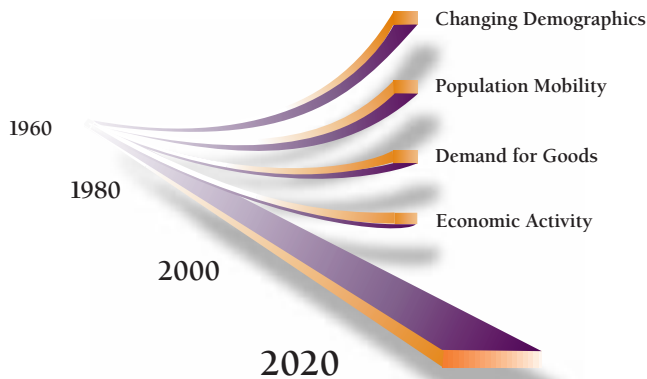


In the Right Gear

We believe we have the vision and performance strategies to support continued expansion in a competitive and dynamic industry. To maintain industry leadership, we plan to continue to strengthen the quality and clarity of our vision and strategies. Although the future has never seemed brighter, we know that real estate activity flows in cycles. Markets experience downturns. The relationship between supply and demand changes. These pressures are magnified by continued self-storage development and industry consolidation, the defining trends in the industry today. An overgrowth of self-storage in a given market could have deleterious effects on occupancy levels and rental rates in that market. As the larger owners of self-storage continue to dominate acquisition and development activities, the competitive landscape becomes more challenging. These operators can be expected to use professional management and media advertising, economies of scale, management efficiencies, quality control, etc. to improve performance. We remain confident that our vision and five performance strategies will continue to make us *The First Choice*.

As is true in most segments of the real estate industry in the United States today, the self-storage sector is fragmented. We estimate the industry is comprised of over 26,000 self-storage properties, most of which are owned by independent local operators. We own interests in 1,073 self-storage properties, making us the largest single self-storage owner and operator in the country. We have an intensive property development strategy and strong balance sheet, fundamentals

Self-Storage Industry: Positioned for Growth





advancing our real estate program. There were about 105 million American households in 1997. Assuming a 10 percent utilization rate, we estimate that at any given point in time approximately 10 million American households are renting self-storage space. That means that 95 million American households are not renting a self-storage unit. This reflects the dimensions of the prospective market for the self-storage industry and for Public Storage in particular.

The Road Ahead

We believe our industry, and specifically our Company, is positioned for growth. The economic and social influences that drive demand in the self-storage industry are strong. These influences, along with our position as the largest operator in the industry and our substantial market penetration, resulted in strong occupancies and realized rents in 1997 for our Company. Revenues and net operating income advanced on a Same Store basis for the year ended December 31, 1997 compared to the previous year.

We believe we have the right vision and strategies to respond to the opportunities and challenges in our industry today. Our operating business and financial position give us the capability to generate rising cash flow and provides us with the opportunity to reinvest a substantial portion of that cash. Our strengths enhance the growth of portable self-storage, retail stores and truck rentals. Our vision and strategies should continue to differentiate us from our competitors and provide advantages in the future. We thank our shareholders, employees and customers for supporting our vision.

Sincerely,

B. Wayne Hughes
*Chairman of the Board
and Chief Executive Officer*

Harvey Lenkin
President

March 31, 1998



Our properties are located in almost every major metropolitan area of the United States. This property is in Atlanta, Georgia.



The Marine Corps' 50th Anniversary Toys for Tots program provided an opportunity to help brighten the holidays for deserving young people last year. The Toys for Tots program used modified Pak & Store™ self-storage containers for holiday toy collection outside selected Target Stores.



Leadership Strategy— Implementing Our Vision

To be *The First Choice* requires our management team to formulate the appropriate responses, system-wide or incremental, to keep the Public Storage system finely tuned for maximum competitive efficiency. In addition to being familiar with our markets, this requires us to be aware of our property management processes and our philosophy about those processes. Our objective of maintaining self-storage industry leadership has not changed. What we see more clearly are the many resources available to us within the Public Storage system to achieve our vision. We are referring to our human resources, the men and women behind the Public Storage name.

We have evolved a plan to bring our vision of being *The First Choice* to each employee by:

- ❑ *Making it known.* We are conveying our vision to employees and everyone else closely connected with the Public Storage system by emphasizing our mutual goals of productivity, pride and performance.
- ❑ *Structuring ourselves to realize our vision.* We are organizing our property management system for optimum efficiency. It uses state-of-the-art systems and controls, performance standards and operating procedures to manage the daily demands of our sizeable enterprise effectively.
- ❑ *Allocating resources to achieve our vision.* We are allocating human and financial resources to achieve our vision. Our national reservation center contributes to our competitive edge by offering our customers new and improved services and products. Our customer service center helps resolve tenant concerns.
- ❑ *Sustaining our vision through policies, procedures and training.* Our policies and procedures help standardize how we manage our national property system. Our training of property management personnel emphasizes customer service. Our on-site property managers are normally the self-storage customer's first face-to-face contact with our Company. Portable self-storage truck drivers are trained to be helpful and courteous; they make the first in-person contact with the public. We want employees who can successfully manage relationships with consumers as well as perform under pressure. We want people who can champion our vision.
- ❑ *Encouraging employees to convey our vision.* We are finding ways to enable our most important internal resource—employees—to convey the vision to customers, the investment community, vendors and potential employees.



The national reservation center is the linchpin in our marketing strategies and an important part of our vision to be *The First Choice*.

Capitalization Strategy—

Maintaining low long-term capital costs

We believe that our strong financial position creates access to capital. Low debt and unsecured credit facilities augment our access to capital for growth. In the last five years we have issued approximately \$1.5 billion of common equity and perpetual preferred in public offerings.

Access to capital for a growing company is essential. Having the organizational structure that can utilize a steady infusion of capital is equally important. Our real estate development and acquisition department identifies and develops properties, and our property management system incorporates extensive technologies and systems and controls to absorb newly developed or acquired properties efficiently.

We believe our access to long-term capital at favorable costs is connected to our quality properties in prime locations, strong trade name, industry position, experienced executives and directors, real estate development/acquisition expertise, long history of successful operations, property management operational systems, innovation and flexibility and conservative distribution policy.

Access to favorable financing and market presence are some of the benefits accruing to a strong trade name. Our 1,073 self-storage properties operate under the most recognized trade name in the self-storage industry. We continue to find ways to augment the status of the Public Storage sign in the marketplace, such as through our “facility repackaging program,” which improves and standardizes the appearance of our properties.



Operations Strategy—

Low self-storage operating costs are advantageous

We believe we are among the most effective self-storage operators in the industry. Our operating efficiency is enhanced by the economies of scale and management efficiencies we enjoy by operating a sizeable, geographically diversified portfolio. A typical feature of a geographically diversified portfolio is stable cash flows. No single self-storage property accounts for more than a small fraction of our revenues. Organizing our properties within geographic markets permits cost-effective allocation of marketing expenditures and management supervision.

Low self-storage operating costs also result from using a comprehensive computerized property management system. This system is in place at all of our self-storage properties, creating a network that is linked to corporate headquarters. The system transmits and receives data regarding unit availability, delinquencies, accounting and cash management. Convenience refinements now allow customers to purchase unit space and products with VISA, MasterCard and American Express credit cards and to complete rental applications through our “publicstorage.com” Internet site.

Revenue Diversification Strategy—

Differentiating ourselves from competitors

Public Storage is a diversified enterprise possessing a strong core operating business—self-storage facilities. We have complemented our core business with subsidiaries operating portable self-storage, retail stores and truck rentals.

Public Storage Pickup & DeliverySM (PSPUD), a subsidiary of Public Storage, operates a portable self-storage business that rents self-storage containers to customers for storage in central warehouses. During 1997, PSPUD opened 45 facilities which combined with its previously opened facilities increased the number of opened facilities to 49 (in 16 states) as of December 31, 1997. In January and February 1998, PSPUD opened five additional facilities. PSPUD has also identified an additional 15 sites in existing markets for development of PSPUD facilities at an aggregate estimated cost of \$67.5 million.



The industry's most recognized trade name.

PSPUD is rapidly establishing a dominant position in this promising segment of the self-storage industry. In this start-up phase, PSPUD is currently producing operating losses. We believe rising market awareness coupled with continued operating efficiencies through the implementation of a newly acquired computer logistics program should cause operating losses to diminish through the course of 1998. Additionally, PSPUD and our self-storage properties share a national reservation system and a coordinated media advertising program, which allows for market strategies that promote both businesses' response to consumer demand.

PS Orangeco, a subsidiary of Public Storage, operated 75 full-service retail stores on December 31, 1997. The subsidiary plans to open 85 additional full-service retail stores over 1998. Almost all newly constructed Public Storage self-storage facilities will feature a retail operation. Retail stores sell locks, boxes, tape and other storage-related merchandise.

PS Orangeco's truck rental activities have increased the number of trucks for rent to 130 at 88 locations. By mid-1998 our subsidiary anticipates having approximately 25 additional locations, encompassing virtually every market in which Public Storage does business.

Risk Management Strategy—

Financial strength

We have pursued a strategy that minimizes debt. Consequently, interest expense has continued to decline, equaling \$6,792,000 during 1997, against \$8,482,000 during 1996. Debt and related interest expense is relatively low compared to our overall asset base. As of December 31, 1997, Public Storage's assets totaled approximately \$3.3 billion, a \$739 million increase from approximately \$2.6 billion one year earlier. Our debt-to-equity ratio was 3.6 percent at December 31, 1997, compared to 4.7 percent one year earlier. Maintaining a low debt load, plus access to capital, should position us to respond to investment opportunities in the self-storage industry. Shareholder's equity equaled \$2.8 billion as of December 31, 1997, approximately 24 percent greater than the \$2.3 billion one year ago.



satisfied customers *NOW...* and *GROWING!*



Future Opportunities

Community commitment

We recognize the importance of community relations. Our efforts to give back to the communities that support us is good for those communities, our operations and our employees. It is important to the quality of life in communities supporting our operations.

For example, PSPUD helped the Marine Corps' Toys for Tots program celebrate its 50th anniversary during the 1997 holiday season. PSPUD provided modified Pak & Store™ self-storage containers for holiday toy collection at select Public Storage facilities in Southern California. PSPUD also arranged to display self-storage containers outside 30 Target Stores throughout the Southern California region to collect toys. PSPUD provided the self-storage containers for charitable events ranging from celebrity basketball games to fun runs to parades. These efforts raised PSPUD's visibility in the communities served and helped brighten the holidays for deserving young people.

Joint venture

In April 1997, we formed a joint venture partnership with a state pension fund to develop up to \$220 million of self-storage facilities. The partnership is funded solely with equity capital provided 30 percent by the Company and 70 percent by the state pension fund. Initially, we contributed eight facilities which were under development to the joint venture partnership. We had invested approximately \$32 million in the joint venture as of December 31, 1997.

Self-storage property acquisitions and development

During 1997, we purchased four self-storage facilities containing approximately 241,000 net rentable square feet of storage space for an aggregate cost of approximately \$18.1 million. In addition, an affiliate of the Company acquired 10 commercial properties with approximately 2.7 million net rentable square feet, for an aggregate acquisition cost of approximately \$166.4 million.

The Company and the construction joint venture partnership also opened nine new self-storage facilities during 1997 that we had developed. Collectively, these facilities encompass 530,000 net rentable square feet. As of December 31, 1997, the Company and the construction joint venture partnership had 21 self-storage facilities (1,442,000 net rentable square feet) in various stages of development and had identified 17 additional facilities (1,031,000 net rentable square feet) which we expect to begin constructing during 1998.

Telecommunications

On December 31, 1996, our national reservation center consisted of 87 representatives. One year later, there were 249 individuals on staff. The national reservation center has evolved into an important linchpin in our marketing strategies. The center helps us raise occupancy and increase market share. We are realizing the benefits of marketing and inventory management techniques with our national reservation center at the hub. We are properly staffed to receive an anticipated 250,000 calls per month during the peak spring and summer periods. In addition to self-storage, the center markets portable self-storage, truck rentals and retail stores. We are aggressively responding to the customer demand we are generating through various media, enabling us to support favorable occupancy trends and rental rates.

Financial Review

Revenues for 1997 increased to \$470,844,000 compared to \$338,951,000 in 1996, representing an increase of \$131,893,000 or 38.9 percent. Net income for 1997 was \$178,649,000 compared to \$153,549,000 in 1996, representing an increase of \$25,100,000 or 16.4 percent. The increase in net income for 1997 compared to 1996 was primarily the result of improved property operations, the acquisition of additional real estate facilities during 1997 and 1996, and the acquisition of additional partnership interests during 1997 and 1996, offset partially by start-up operating losses in PSPUD's portable self-storage business.

Net income allocable to common shareholders was \$90,256,000 or \$.91 per common share on a diluted basis (based on 98,961,000 weighted average shares) for 1997 compared to \$84,950,000 or \$1.10 per common share on a diluted basis (based on 77,358,000 weighted average shares) for 1996. In computing net income per common share, dividends to the Company's preferred shareholders (\$88,393,000 and \$68,599,000 for 1997 and 1996, respectively) have been deducted from net income in determining net income allocable to the Company's common shareholders. Net income allocable to common shareholders has been negatively impacted by losses generated from PSPUD's portable self-storage business which generated operating losses of \$31,665,000 or approximately \$.32 per common share on a diluted basis in 1997 (\$826,000, or approximately \$.01 per common share on a diluted basis in 1996).

In addition, net income allocable to the common shareholders for 1997 was negatively affected by a special dividend totaling \$13,412,000 paid to the Company's Series CC Convertible Preferred Stock during the first quarter of 1997. As a result of the special dividend, the Company would not have to pay another dividend on this stock until the quarter ended March 31, 1999. During the second quarter of 1997, the Series CC Convertible Preferred Stock converted into common stock of the Company. Accordingly, all of the \$13,412,000 (\$.14 per common share on a diluted basis) of dividends were treated during 1997 as an allocation of net income to the preferred shareholders in determining the allocation of net income to the common shareholders. The special dividend eliminated the quarterly dividend of \$1.9 million and annual fixed charges of \$7.6 million.

Funds from operations per common share on a fully-diluted basis for 1997 were \$1.97, compared to \$1.98 for 1996, decreasing \$.01 per common share. Funds from operations per common share on a fully-diluted basis for 1997 were negatively impacted by the dilutive effects of start-up losses from PSPUD's portable self-storage operations which resulted in a reduction of \$.32 per common share for 1997. In addition, funds from operations for 1996 were negatively impacted by the effect of the Company's Series CC Convertible Preferred Stock.

Same Stores

For 1997, occupancy at the self-storage properties on a Same Store basis averaged 91.8 percent, compared to 91.2 percent during 1996. Same Store average annual realized rents were \$9.24 per square foot for 1997, a 5.5 percent increase compared to

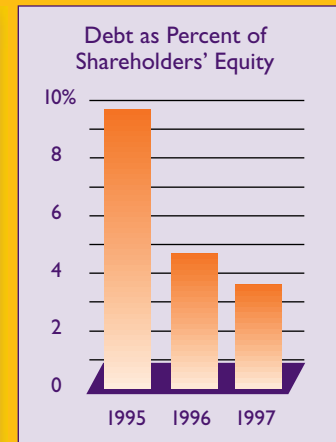
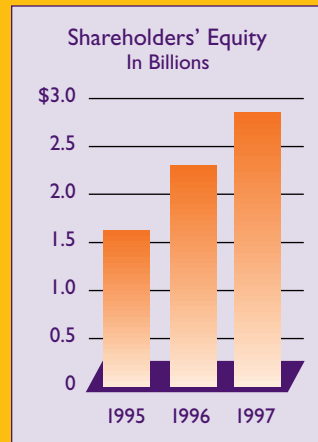
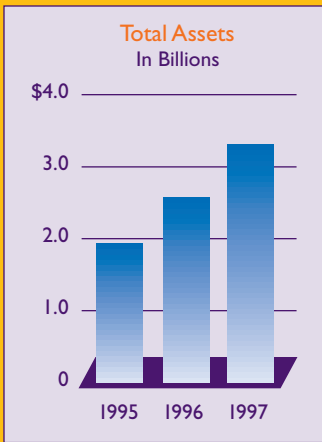
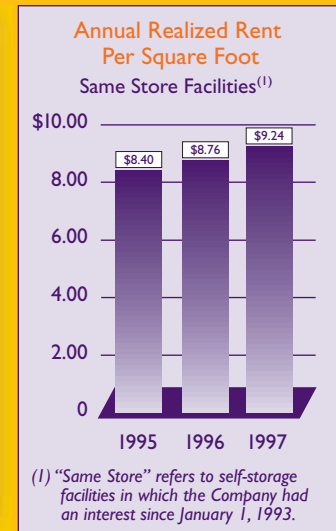
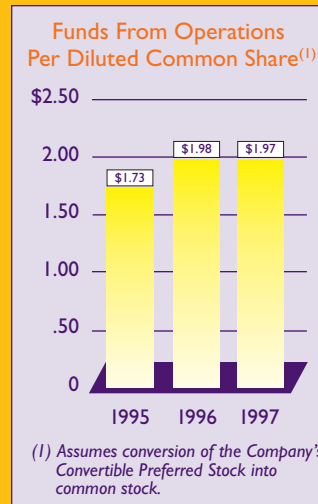
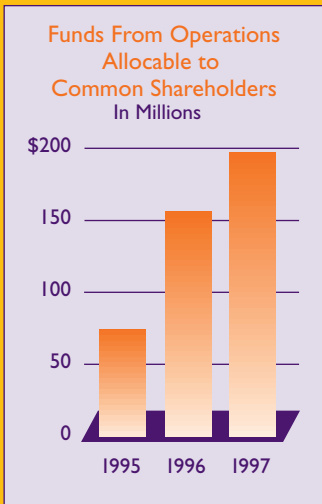
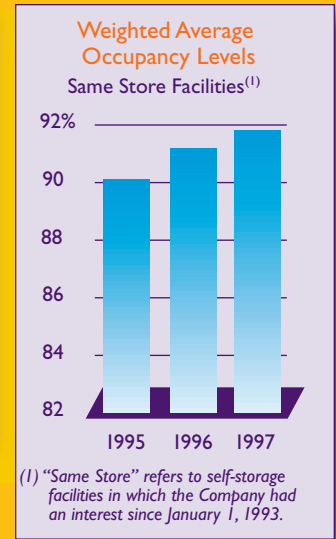
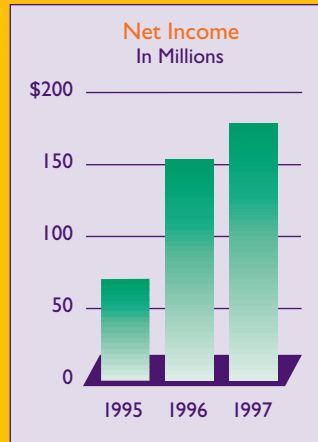
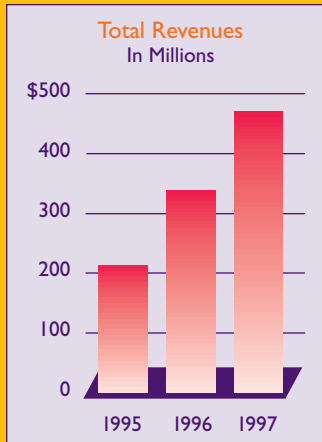


\$8.76 per square foot for 1996. Realized rent per square foot represents the actual revenue earned per occupied square foot. This is believed to be a more relevant measure than posted or scheduled rates, since posted rates can be discounted through promotions. Same Store rental income increased 6.6 percent (\$475.2 million for 1997 versus \$445.6 million for 1996). Same Store cost of operations increased 6.0 percent (\$167.7 million for 1997 versus \$158.2 million for 1996).

Dividend

The Board of Directors declared a \$.22 per common share quarterly dividend on March 2, 1998, along with quarterly dividends on the Company's various series of preferred stock. Distributions are payable on March 31, 1998 to shareholders of record as of the close of business on March 16, 1998. Dividends of \$.88 per share were paid on the common stock in 1997.

The Company believes that its practice of minimizing distributions adds to shareholder value. Retaining a substantial portion of funds from operations (after funding distributions and capital improvements) enables the Company to acquire and develop properties, invest in its other operations, and reduce debt using internal cash resources. This is one of the ways the Company believes its vision and strategies separate it from its competitors. The Company distributed 44 percent of funds from operations per common share for 1997 and 43 percent for 1996. Through its relatively moderate payout ratio in 1997 it retained \$78.5 million of capital (\$110.2 million adding back losses on PSPUD operations) to purchase and develop properties and invest in its other operations.





Consolidated Balance Sheets

December 31, 1997 and 1996

(In thousands, except per share data)	December 31, 1997	December 31, 1996
Assets		
Cash and cash equivalents	\$ 41,455	\$ 26,856
Real estate facilities, at cost:		
Land	845,299	596,141
Buildings	2,232,230	1,589,357
	3,077,529	2,185,498
Accumulated depreciation	(378,248)	(297,655)
	2,699,281	1,887,843
Construction in process	42,635	35,815
	2,741,916	1,923,658
Investment in real estate entities	225,873	350,190
Intangible assets, net	212,944	222,253
Mortgage notes receivable from affiliates	21,807	25,016
Other assets	67,650	24,179
Total assets	\$3,311,645	\$2,572,152
Liabilities and Shareholders' Equity		
Revolving line of credit	\$ 7,000	\$ —
Notes payable	96,558	108,443
Accrued and other liabilities	70,648	41,467
Total liabilities	174,206	149,910
Minority interest	288,479	116,805
Commitments and contingencies	—	—
Shareholders' Equity:		
Preferred Stock, \$0.01 par value, 50,000,000 shares authorized, 13,261,984 shares issued and outstanding (13,421,580 issued and outstanding at December 31, 1996), at liquidation preference:		
Cumulative Preferred Stock, issued in series	868,900	718,900
Convertible Preferred Stock	53,308	114,929
Common stock, \$0.10 par value, 200,000,000 shares authorized, 105,102,145 shares issued and outstanding (88,362,026 at December 31, 1996)	10,511	8,837
Class B Common Stock, \$0.10 par value, 7,000,000 shares authorized and issued	700	700
Paid-in capital	1,903,782	1,454,387
Cumulative net income	575,069	396,420
Cumulative distributions paid	(563,310)	(388,736)
Total shareholders' equity	2,848,960	2,305,437
Total liabilities and shareholders' equity	\$3,311,645	\$2,572,152

See accompanying notes.



Consolidated Statements of Income

For each of the three years in the period ended December 31, 1997

(In thousands, except per share data)	1997	1996	1995
Revenues:			
Rental income:			
Self-storage facilities	\$385,540	\$270,429	\$184,100
Commercial properties	40,575	23,576	18,034
Portable self-storage	7,893	421	—
Equity in earnings of real estate entities	17,569	22,121	3,763
Facility management fee	10,141	14,428	2,144
Interest and other income	9,126	7,976	4,509
	<u>470,844</u>	<u>338,951</u>	<u>212,550</u>
Expenses:			
Cost of operations:			
Self-storage facilities	117,963	82,494	63,396
Commercial properties	16,665	10,750	8,851
Portable self-storage	39,558	1,247	—
Cost of facility management	1,793	2,575	352
Depreciation and amortization	91,356	64,967	40,760
General and administrative	6,384	5,524	3,982
Interest expense	6,792	8,482	8,508
Environmental cost	—	—	2,741
Advisory fee	—	—	6,437
	<u>280,511</u>	<u>176,039</u>	<u>135,027</u>
Income before minority interest	190,333	162,912	77,523
Minority interest in income	(11,684)	(9,363)	(7,137)
Net income	<u>\$178,649</u>	<u>\$153,549</u>	<u>\$ 70,386</u>
Net income allocation:			
Allocable to preferred shareholders	\$ 88,393	\$ 68,599	\$ 31,124
Allocable to common shareholders	90,256	84,950	39,262
	<u>\$178,649</u>	<u>\$153,549</u>	<u>\$ 70,386</u>
Per Common Share:			
Basic net income per share	\$ 0.92	\$ 1.10	\$ 0.96
Diluted net income per share	\$ 0.91	\$ 1.10	\$ 0.95
Basic weighted average common shares outstanding	98,446	77,117	41,039
Diluted weighted average common shares outstanding	98,961	77,358	41,171

See accompanying notes.



Consolidated Statements of Shareholders' Equity

For each of the three years in the period ended December 31, 1997

(In thousands, except share and per share amounts)	Preferred Stock		Common Stock
	Cumulative	Convertible	
Balances at December 31, 1994	\$165,275	\$ 57,500	\$ 2,883
Issuance of Preferred Stock, net of issuance costs:			
Series E, F, and G (4,501,900 shares)	284,875	—	—
Convertible Participating (31,200 shares)	—	28,470	—
Issuance of Common Stock (42,687,092 shares)	—	—	4,269
Issuance of Class B Common Stock (7,000,000 shares)	—	—	—
Net income	—	—	—
Cash distributions:			
Preferred Stock	—	—	—
Common Stock, \$0.88 per share	—	—	—
Balances at December 31, 1995	450,150	85,970	7,152
Issuance of Preferred Stock, net of issuance costs:			
Series H and I (10,750 shares)	268,750	—	—
Convertible, Series CC (58,955 shares)	—	58,955	—
Issuance of Common Stock (15,134,241 shares)	—	—	1,514
Conversion of Convertible Participating Preferred Stock into Common Stock (1,611,265 shares)	—	(28,470)	161
Conversion of 8.25% Convertible Preferred Stock into Common Stock (102,721 shares)	—	(1,526)	10
Net income	—	—	—
Cash distributions:			
Preferred Stock	—	—	—
Common Stock, \$0.88 per share	—	—	—
Balances at December 31, 1996	718,900	114,929	8,837
Issuance of Preferred Stock, net of issuance costs:			
Series J (6,000 shares)	150,000	—	—
Issuance of Common Stock (14,376,218 shares)	—	—	1,438
Conversion of Series CC Convertible Preferred Stock into Common Stock (2,184,250 shares)	—	(58,955)	218
Conversion of 8.25% Convertible Preferred Stock into Common Stock (179,651 shares)	—	(2,666)	18
Net income	—	—	—
Cash distributions:			
Preferred Stock	—	—	—
Common Stock, \$0.88 per share	—	—	—
Balances at December 31, 1997	\$868,900	\$ 53,308	\$10,511

See accompanying notes.



Class B Common Stock	Paid-in Capital	Cumulative Net Income	Cumulative Distributions	Total Shareholders' Equity
\$ —	\$ 372,361	\$172,485	\$(182,718)	\$ 587,786
—	(9,718)	—	—	275,157
—	664,645	—	—	28,470
700	72,800	—	—	668,914
—	—	70,386	—	73,500
—	—	—	(31,124)	70,386
—	—	—	(38,586)	(31,124)
700	1,100,088	242,871	(252,428)	(38,586)
—	(8,972)	—	—	1,634,503
—	—	—	—	259,778
—	333,956	—	—	58,955
—	27,799	—	—	335,470
—	1,516	—	—	(510)
—	—	153,549	—	—
—	—	—	(68,599)	153,549
—	—	—	(67,709)	(68,599)
700	1,454,387	396,420	(388,736)	(67,709)
—	(5,075)	—	—	2,305,437
—	393,085	—	—	144,925
—	58,737	—	—	394,523
—	2,648	—	—	—
—	—	178,649	—	—
—	—	—	(88,393)	178,649
—	—	—	(86,181)	(88,393)
\$ 700	\$1,903,782	\$575,069	\$(563,310)	(86,181)
				\$2,848,960



Consolidated Statements of Cash Flows

For each of the three years in the period ended December 31, 1997

(In thousands)	1997	1996	1995
Cash Flows From Operating Activities:			
Net income	\$ 178,649	\$ 153,549	\$ 70,386
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	91,356	64,967	40,760
Depreciation included in equity in earnings of real estate entities	11,474	17,450	2,045
Environmental accrual (including \$510 from equity in earnings of real estate entities)	—	—	3,251
Minority interest in income	11,684	9,363	7,137
Total adjustments	114,514	91,780	53,193
Net cash provided by operating activities	293,163	245,329	123,579
Cash Flows From Investing Activities:			
Principal payments received on mortgage notes receivable	409	1,784	2,063
Acquisition of minority interests in consolidated real estate partnerships	(21,559)	(15,419)	(32,683)
Acquisition of mortgage notes receivable	—	(3,709)	(12,355)
Acquisition of real estate facilities	(65,225)	(198,404)	(103,061)
Acquisition cost of business combinations	(164,808)	(113,522)	(57,374)
Acquisition of interests in real estate entities	(46,151)	(83,893)	(20,657)
Investment in portable self-storage business	(29,997)	—	—
Construction in process	(45,865)	(46,097)	(13,244)
Capital improvements to real estate facilities	(35,117)	(20,366)	(11,361)
Net cash used in investing activities	(408,313)	(479,626)	(248,672)
Cash Flows From Financing Activities:			
Net borrowings (paydowns) on revolving line of credit	7,000	—	(37,607)
Net proceeds from the issuances of preferred stock	144,925	259,778	275,157
Net proceeds from the issuances of common stock	182,523	130,538	80,526
Principal payments on mortgage notes payable	(11,885)	(51,310)	(39,212)
Distributions paid to shareholders	(174,574)	(136,308)	(69,072)
Distributions from operations to minority interests in consolidated real estate partnerships	(20,929)	(20,853)	(18,380)
Net reinvestment by minority interests in consolidated real estate partnerships	3,527	3,976	(1,739)
Other	(838)	(5,104)	(4,295)
Net cash provided by financing activities	129,749	180,717	185,378
Net increase (decrease) in cash and cash equivalents	14,599	(53,580)	60,285
Cash and cash equivalents at the beginning of the year	26,856	80,436	20,151
Cash and cash equivalents at the end of the year	\$ 41,455	\$ 26,856	\$ 80,436

See accompanying notes.



For each of the three years in the period ended December 31, 1997

(In thousands)	1997	1996	1995
SUPPLEMENTAL SCHEDULE OF NONCASH INVESTING AND FINANCING ACTIVITIES			
Investing Activities:			
Acquisition of real estate facilities in exchange for minority interests, common stock, the assumption of mortgage notes payable, the cancellation of mortgage notes receivable and the reduction of investment in real estate entities	\$(119,279)	\$ (4,292)	\$ (87,941)
Business combinations (Note 3):			
Real estate facilities	(657,347)	(531,794)	(230,519)
Investment in real estate entities	189,400	124,696	(385,222)
Mortgage notes receivable	—	—	(6,667)
Other assets	(4,119)	(5,849)	(8,862)
Intangible assets	—	—	(232,726)
Accrued and other liabilities	21,190	15,399	17,134
Notes payable	—	—	96,728
Minority interest	74,068	20,139	17,034
Reduction of investment in real estate entities in exchange for real estate facilities	—	1,891	—
Investment in real estate entities	30,406	—	—
Acquisition of partnership interests in real estate entities in exchange for common stock	—	—	(4,034)
Financing Activities:			
Cancellation of mortgage notes receivable to acquire real estate facilities	—	700	16,435
Assumption of mortgage notes payable upon the acquisition of real estate facilities	—	1,701	60,908
Reduction in construction in process — contribution to joint venture	(30,406)	—	—
Minority interest issued in exchange for real estate facilities	119,279	—	—
Accrued and unpaid distributions	—	—	638
Issuance of Preferred Stock:			
Mandatory Convertible Preferred Stock, Series CC to acquire interest in consolidated real estate partnerships	—	58,955	—
Mandatory Convertible Participating Preferred Stock to acquire interest in consolidated real estate partnerships	—	—	28,470
Issuance of Common Stock:			
In connection with mergers	212,000	204,932	573,756
Acquire real estate facilities	—	—	10,598
Acquire partnership interests in real estate entities	—	—	4,034
In connection with conversion of Convertible Preferred Stock	61,621	29,486	—
Issuance of Class B Common Stock in connection with mergers	—	—	73,500
Conversion of 8.25% Convertible Preferred Stock	(2,666)	(1,526)	—
Conversion of Mandatory Convertible Preferred Stock	(58,955)	(28,470)	—

See accompanying notes.



Notes to Consolidated Financial Statements

December 31, 1997

Note 1. Description of the Business

Public Storage, Inc. (the "Company") is a California corporation which was organized in 1980. The Company is a fully integrated, self-administered and self-managed real estate investment trust ("REIT") that acquires, develops, owns and operates self-storage facilities which offer self-storage spaces for lease, usually on a month-to-month basis, for personal and business use. The Company, through a majority-owned subsidiary, also owns and operates commercial properties containing commercial and industrial rental space.

Prior to November 16, 1995, the Company's operations were managed, pursuant to contractual arrangements, by Public Storage Advisers, Inc. (the "Adviser"), the Company's investment advisor, by Public Storage Management, Inc. ("PSMI"), its self-storage facilities property operator and by Public Storage Commercial Properties Group, Inc., its commercial property operator. On November 16, 1995, in a series of mergers among PSMI and its affiliates, culminating in the merger of PSMI into the Company (the "PSMI Merger"), the Company became self-administered and self-managed and acquired substantially all of the United States real estate operations of PSMI.

In 1996 and 1997, the Company organized Public Storage Pickup and Delivery, Inc. as a separate corporation and a related partnership (the corporation and partnership are collectively referred to as "PSPUD") to operate a portable self-storage business that rents storage containers to customers for storage in central warehouses. At December 31, 1997, PSPUD operated 49 facilities in 16 states.

On January 2, 1997, the Company reorganized its commercial property operations into a separate private REIT (the "Private REIT"). The Private REIT contributed its assets to a newly created operating partnership (the "Operating Partnership") in exchange for a general partnership interest and limited partnership interests. The Company and certain partnerships in which the Company has a controlling interest contributed substantially all of their commercial properties to the Operating Partnership in exchange for limited partnership interests or to the Private REIT in exchange for common stock. At December 31, 1997, the Private REIT and the Operating Partnership owned 49 properties located in 10 states. The Operating Partnership also managed the commercial properties owned by the Company and affiliated entities. As of December 31, 1997, the Company owned approximately 53% of the Private REIT which owned approximately 19% of the Operating Partnership. The balance of the Operating Partnership is primarily owned by the Company and partnerships controlled by the Company. On March 17, 1998, the Private REIT merged into Public Storage Properties XI, Inc., an affiliated publicly traded REIT and the name of the surviving corporation was changed to PS Business Parks, Inc. ("PSBP").

The Company invests in real estate facilities primarily through the acquisition of wholly-owned facilities combined with the acquisition of equity interests in real estate entities owning real estate facilities. At December 31, 1997, the Company had direct and indirect equity interests in 1,136 properties located in 38 states, including 1,073 self-storage facilities and 63 commercial properties. All of these facilities are operated by the Company under the "Public Storage" name.

Note 2. Summary of Significant Accounting Policies

Basis of presentation

The consolidated financial statements include the accounts of the Company, PSPUD, the Private REIT, the Operating Partnership, and 33 controlled limited partnerships (the "Consolidated Entities"). Collectively, the Company, the Operating Partnership and the Consolidated Entities own a total of 955 real estate facilities, consisting of 894 self-storage facilities and 61 commercial properties.

At December 31, 1997, the Company also has equity investments in 29 other affiliated limited partnerships and two REITs owning in aggregate 181 real estate facilities (179 self-storage facilities and 2 commercial properties) which are managed by the Company. The Company's ownership interest in such real estate entities is less than 50% of the total equity interest and the Company's investments in these entities are accounted for using the equity method.

Use of estimates

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

Income taxes

For all taxable years subsequent to 1980, the Company qualified and intends to continue to qualify as a REIT, as defined in Section 856 of the Internal Revenue Code. As a REIT, the Company is not taxed on that portion of its taxable income which is distributed to its shareholders provided that the Company meets certain tests. The Company believes it has met these tests during 1997, 1996 and 1995; accordingly, no provision for income taxes has been made in the accompanying financial statements.



Financial instruments

For purposes of financial statement presentation, the Company considers all highly liquid debt instruments purchased with a maturity of three months or less to be cash equivalents.

The carrying amount of cash and cash equivalents and mortgage notes receivable approximates fair value because with respect to cash and cash equivalents maturities are less than three months and with respect to the mortgage notes receivable applicable interest rates approximate market rates for these loans. The carrying amount of the Company's fixed rate long-term debt is estimated using discounted cash flow analyses based on incremental borrowing rates the Company believes it could obtain with similar terms and maturities.

Real estate facilities

Real estate facilities are recorded at cost. Depreciation is computed using the straight-line method over the estimated useful lives of the buildings and improvements, which are generally between 5 and 25 years.

Allowance for possible losses

The Company has no allowance for possible losses relating to any of its real estate investments, long-lived assets and mortgage notes receivable. The need for such an allowance is evaluated by management by means of periodic reviews of its investment portfolio.

Intangible assets

Intangible assets consist of property management contracts (\$165,000,000) and the cost over the fair value of net tangible and identifiable intangible assets (\$67,726,000) acquired in the PSMI Merger. Intangible assets are amortized straight-line over 25 years. At December 31, 1997 and 1996, intangible assets are net of accumulated amortization of \$19,782,000 and \$10,473,000, respectively. Included in depreciation and amortization expense is \$9,309,000 in 1997, \$9,309,000 in 1996 and \$1,164,000 in 1995 (for the period from November 16, 1995 through December 31, 1995) related to the amortization of intangible assets.

Revenue and expense recognition

Property rents are recognized as earned. Equity in earnings of real estate entities are recognized based on the Company's ownership interest in the earnings of each of the unconsolidated real estate entities. Advertising costs are expensed as incurred.

Environmental costs

The Company's policy is to accrue environmental assessments and/or remediation cost when it is probable that such efforts will be required and the related costs can be reasonably estimated. The majority of the Company's real estate facilities were acquired prior to the time that it was customary to conduct environmental assessments. During 1995, the Company and the Consolidated Entities conducted independent environmental investigations of their real estate facilities. As a result of these investigations, the Company recorded an amount which, in management's best estimate and based upon independent analysis, was sufficient to satisfy anticipated costs of known remediation requirements. At December 31, 1995, the Company accrued \$2,741,000 for estimated environmental remediation costs. Similar to the Company, real estate entities in which the Company accounts for using the equity method recorded environmental accruals at the end of 1995. The Company's pro rata share, based on its ownership interest, totaled \$510,000 and is included in "Equity in earnings of real estate entities" in 1995. Although there can be no assurance, the Company is not aware of any environmental contamination of any of its facilities which individually or in the aggregate would be material to the Company's overall business, financial condition, or results of operations.

Net income per common share

In 1997, the Financial Accounting Standards Board issued Statement No. 128, *Earnings per Share*. Statement 128 replaced the calculation of primary and fully diluted net income per share with basic and diluted net income per share. Unlike primary net income per share, basic net income per share excludes any dilutive effects of options, warrants and convertible securities. Diluted net income per share is very similar to the previously reported fully diluted net income per share. All net income per share amounts for all periods have been presented and where appropriate, restated to conform to Statement 128 requirements.

Diluted net income per common share is computed using the weighted average common shares outstanding (adjusted for stock options). The Class B Common Stock is not included in the determination of net income per common share because all contingencies required for the conversion to common stock have not been satisfied as of December 31, 1997. In addition, the inclusion of the Company's convertible preferred stock in the determination of net income per common share has been determined to be anti-dilutive.

In computing earnings per common share, preferred stock dividends totaling \$88,393,000, \$68,599,000 and \$31,124,000 for the years ended December 31, 1997, 1996 and 1995, respectively, reduced income available to common stockholders.

**Stock-based compensation**

In October 1995, the FASB issued SFAS No. 123 "Accounting for Stock-Based Compensation" ("Statement 123") which provides companies an alternative to accounting for stock-based compensation as prescribed under APB Opinion No. 25 (APB 25). Statement 123 encourages, but does not require companies to recognize expense for stock-based awards based on their fair value at date of grant. Statement 123 allows companies to continue to follow existing accounting rules (intrinsic value method under APB 25) provided that pro-forma disclosures are made of what net income and earnings per share would have been had the new fair value method been used. The Company has elected to adopt the disclosure requirements of Statement 123 but will continue to account for stock-based compensation under APB 25. Statement 123's disclosure requirements are applicable to stock-based awards granted in fiscal years beginning after December 15, 1994.

Reclassifications

Certain reclassification have been made to the consolidated financial statements for the years ended December 31, 1996 and 1995 in order to conform with the 1997 presentation.

Note 3. Business Combinations**Mergers with affiliated REITs**

During 1997, the Company completed merger transactions with six affiliated public REITs whereby the Company acquired all the outstanding stock of the REITs which it did not previously own in exchange for cash and common stock of the Company. The aggregate acquisition cost of these mergers is summarized as follows:

Entity	Date of merger	Merger consideration (In thousands)			
		Common Stock	Cash	Pre-existing investment	Total
Public Storage Properties XIV, Inc.	April 11, 1997	\$ 34,450	\$ 9,145	\$ 19,977	\$ 63,572
Public Storage Properties XV, Inc.	April 11, 1997	29,764	8,883	18,137	56,784
Public Storage Properties XVI, Inc.	June 24, 1997	41,060	10,804	22,225	74,089
Public Storage Properties XVII, Inc.	June 24, 1997	34,590	15,793	25,862	76,245
Public Storage Properties XVIII, Inc.	June 24, 1997	39,727	17,570	19,841	77,138
Public Storage Properties XIX, Inc.	June 24, 1997	32,409	6,667	18,003	57,079
		\$212,000	\$68,862	\$124,045	\$404,907

During 1996, the Company completed merger transactions with eight affiliated public REITs whereby the Company acquired all the outstanding stock of the REITs for an aggregate cost of \$356,835,000, consisting of the issuance of 8,839,181 shares of the Company's common stock (\$204,932,000), \$79,461,000 reduction of the Company's pre-existing investment and \$72,442,000 in cash.

Affiliated partnership acquisitions:

During 1997, the Company increased its ownership interest in 12 affiliated limited partnerships in which the Company is the general partner. Prior to the acquisitions, the Company accounted for its investment in each of the 12 partnerships using the equity method. As a result of increasing its ownership interest and obtaining control of the partnerships, the Company began to consolidate the accounts of the partnerships in the Company's consolidated financial statements. These transactions are summarized as follows:

Entity	Economic Interest after Acquisition	Date Purchased	Cash	Pre-existing investment	Total
(In thousands)					
PS Institutional Fund II	75%	Sept. 1997	\$52,124	\$44,262	\$ 96,386
PS Miniwarehouses Funds I-IX	95%	Oct. 1997	28,244	4,582	32,826
PS Co-Investment Partnership	52%	Nov. 1997	15,578	16,511	32,089
			\$95,946	\$65,355	\$161,301

During 1996, the Company increased its ownership interest and obtained control of three limited partnerships. As a result, commencing in 1996, the Company began to consolidate the accounts of these partnerships for financial statement purposes. The aggregate amount of the interests acquired totaled \$145,270,000 consisting of the issuance of \$58,955,000 of Series CC Convertible Preferred Stock, \$45,235,000 reduction of the Company's pre-existing investment and cash of \$41,080,000.

Each of the above mergers with affiliated REITs and acquisitions of partnership interests discussed above has been accounted for as a purchase; accordingly, allocations of the total acquisition cost to the net assets acquired were made based on the fair value of such assets and



liabilities as of the dates of each respective transaction. The fair market values of the assets acquired and liabilities assumed with respect to the transactions occurring in 1997 and 1996 are summarized as follows:

(In thousands)	REIT mergers	Partnership Acquisitions	Total
1997 business combinations:			
Real estate facilities	\$413,597	\$243,750	\$657,347
Other assets	2,424	1,695	4,119
Accrued and other liabilities	(11,114)	(10,076)	(21,190)
Minority interest	—	(74,068)	(74,068)
	\$404,907	\$161,301	\$566,208
1996 business combinations:			
Real estate facilities	\$364,984	\$166,810	\$531,794
Other assets	5,032	817	5,849
Accrued and other liabilities	(13,181)	(2,218)	(15,399)
Minority interest	—	(20,139)	(20,139)
	\$356,835	\$145,270	\$502,105

The historical operating results of the above acquisitions prior to each respective acquisition date have not been included in the Company's historical operating results. Pro forma data (unaudited) for the years ended December 31, 1997 and 1996 as though the business combinations above had been effective at the beginning of fiscal 1996 are as follows:

(In thousands, except per share data)	For the Year Ended December 31,	
	1997	1996
Revenues	\$515,286	\$453,940
Net income	\$181,678	\$173,542
Net income per common share (Basic)	\$ 0.92	\$ 1.13
Net income per common share (Diluted)	\$ 0.91	\$ 1.13

The pro forma data does not purport to be indicative either of results of operations that would have occurred had the transactions occurred at the beginning of fiscal 1996 or future results of operations of the Company. Certain pro forma adjustments were made to the combined historical amounts to reflect (i) expected reductions in general and administrative expenses, (ii) estimated increased interest expense from bank borrowings to finance the cash portion of the acquisition cost and (iii) estimated increase in depreciation and amortization expense.

Note 4. Real Estate Facilities

Activity in real estate facilities during 1997, 1996 and 1995 is as follows:

(In thousands)	1997	1996	1995
Operating facilities, at cost:			
Beginning balance	\$2,185,498	\$1,405,155	\$ 967,718
Property acquisitions:			
Business combinations (Note 3)	657,347	531,794	230,519
Other acquisitions	184,504	202,696	191,002
Developed facilities	8,639	18,261	5,265
Acquisition of minority interest (Note 8)	8,904	7,226	(223)
Capital improvements	35,117	20,366	11,361
Property dispositions	(2,480)	—	(487)
Ending balance	3,077,529	2,185,498	1,405,155
Accumulated depreciation:			
Beginning balance	(297,655)	(241,966)	(202,745)
Additions during the year	(82,047)	(55,689)	(39,376)
Property dispositions	1,454	—	155
Ending balance	(378,248)	(297,655)	(241,966)
Construction in progress:			
Beginning balance	35,815	7,979	—
Current development cost	45,865	46,097	13,244
Property contribution to real estate entities	(30,406)	—	—
Newly opened development facilities	(8,639)	(18,261)	(5,265)
Ending balance	42,635	35,815	7,979
Total real estate facilities	\$2,741,916	\$1,923,658	\$1,171,168



During 1997, the Company acquired a total of 176 real estate facilities for an aggregate cost of \$657,347,000 in connection with certain business combinations (Note 3). The Company also acquired an additional 14 real estate facilities from third parties with an aggregate acquisition cost of \$184,504,000 consisting of the issuance of minority interests (\$119,279,000) and cash (\$65,225,000).

During 1996, the Company acquired a total of 154 real estate facilities for an aggregate cost of \$531,794,000 in connection with certain business combinations (Note 3). The Company also acquired an additional 58 real estate facilities from third parties with an aggregate acquisition cost of \$202,696,000 consisting of the cancellation of mortgage notes receivable (\$700,000), cancellation of pre-existing investments (\$1,891,000), assumption of mortgage notes payable (\$1,701,000), and cash (\$198,404,000).

During 1995, the Company acquired a total of 95 real estate facilities for an aggregate cost of \$230,519,000 in connection with certain business combinations. During 1995, the Company also acquired an additional 57 real estate facilities for an aggregate cost of \$191,002,000 consisting of the cancellation of mortgage notes receivable (\$16,435,000), the assumption of mortgage notes payable (\$60,908,000), issuance of common stock (\$10,598,000) and cash (\$103,061,000).

Commencing in 1995, the Company began to construct self-storage facilities and in 1997 PSPUD commenced construction of portable self-storage facilities. Through December 31, 1997, the Company constructed and opened for operation seven self-storage facilities, one of which began operations in August 1995, four in 1996 and two in 1997. Included in construction in progress at December 31, 1997 are costs related to the construction of four self-storage facilities and 10 portable self-storage facilities and an additional 17 self-storage facilities and 5 portable self-storage facilities planned for development.

A substantial number of the real estate facilities acquired during 1997, 1996 and 1995 were acquired from affiliates in connection with business combinations with an aggregate acquisition cost of approximately \$657,347,000, \$531,794,000 and \$230,519,000 respectively.

In April 1997, the Company and a state pension fund created a joint venture partnership for the purpose of developing up to \$220 million of self-storage facilities. The Company owns 30% of the partnership interest and the state pension fund owns the remaining 70% interest. In connection with the formation of the joint venture partnership, the Company contributed eight self-storage facilities (\$30,406,000), which were under construction, to the joint venture partnership in exchange for its partnership interest. The Company's investment in the joint venture partnership is accounted for using the equity method (See Note 5).

At December 31, 1997, the adjusted basis of real estate facilities for Federal income tax purposes was approximately \$2.3 billion which is net of accumulated depreciation of \$733 million.

Note 5. Investments in Real Estate Entities

During 1997 and 1996, the Company's investment in real estate entities decreased principally as a result of business combinations whereby the Company eliminated approximately \$189.4 million and \$124.7 million of pre-existing equity in real estate entity investments, respectively. Offsetting these decreases are additional investments in numerous other unconsolidated affiliates for \$46.2 million and \$83.9 million in 1997 and 1996, respectively, in cash.

During 1995, the Company (i) acquired limited and general partnership interests in 47 partnerships and common stock in 16 REITs in connection with the PSMI Merger at an aggregate cost of \$389,686,000, (ii) acquired additional interests in some of the same partnerships and REITs for an aggregate cost of \$23,953,000, consisting of common stock (\$4,034,000) and cash (\$19,919,000) and (iii) reclassified investments in partnerships which commencing in 1995 are consolidated with the Company (\$4,464,000).

At December 31, 1997, the Company's investments in real estate entities consist generally of ownership interests in 29 affiliated partnerships and common stock in two affiliated REITs. Such interests consist of ownership interests of less than 50% and are accounted for using the equity method of accounting. Accordingly, earnings are recognized by the Company based upon the Company's ownership interest in each of the partnerships and REITs. Provisions of the governing documents of the partnerships and REITs provide for the payment of preferred cash distributions to other investors (until certain specified amounts have been paid) without regard to the pro rata interest of investors in current earnings.

During 1997, 1996 and 1995, the Company recognized earnings from its investments of \$17,569,000, \$22,121,000 and \$3,763,000, respectively, and received cash distributions totaling \$15,673,000, \$27,326,000 and \$5,580,000, respectively. Included in equity in earnings of real estate entities for 1997, 1996 and 1995 is the Company's share of depreciation expense (\$11,474,000, \$17,450,000 and \$2,045,000, respectively) and environmental costs (\$510,000 in 1995) of the real estate entities.



Summarized combined financial data (based on historical cost) with respect to those real estate entities in which the Company had an ownership interest at December 31, 1997 are as follows:

(In thousands)	1997	1996
Year ended December 31,		
Rental income	\$ 94,652	\$ 86,581
Total revenues	\$ 96,650	\$ 87,945
Cost of operations	\$ 33,077	\$ 30,306
Depreciation	\$ 12,805	\$ 11,648
Net income	\$ 40,775	\$ 35,660
At December 31,		
Total assets, net of accumulated depreciation	\$467,002	\$363,490
Total debt	\$ 77,513	\$ 80,549
Total equity	\$370,546	\$271,623

As indicated above, in April 1997, the Company and a state pension fund formed a joint venture partnership for the purpose of developing up to \$220 million of self-storage facilities. As of December 31, 1997, the joint venture partnership had completed construction on seven self-storage facilities with a total cost of approximately \$40.8 million, and had 17 facilities under construction with an aggregate cost incurred to date of approximately \$48.9 million and total additional estimated cost to complete of \$29.3 million. The partnership is funded solely with equity capital consisting of 30% from the Company and 70% from the state pension fund.

Note 6. Revolving Line of Credit

As of December 31, 1997, the Company had borrowings of \$7 million (none at March 27, 1998) on its unsecured credit agreement with a group of commercial banks. The credit agreement (the "Credit Facility") has a borrowing limit of \$150 million and an expiration date of July 31, 2001. The expiration date may be extended by one year on each anniversary of the credit agreement. Interest on outstanding borrowings is payable monthly. At the option of the Company, the rate of interest charged is equal to (i) the prime rate or (ii) a rate ranging from the London Interbank Offered Rate ("LIBOR") plus 0.40% to LIBOR plus 1.10% depending on the Company's credit ratings and coverage ratios, as defined. In addition, the Company is required to pay a quarterly commitment fee of 0.250% (per annum) of the unused portion of the Credit Facility. The Credit Facility allows the Company, at its option, to request the group of banks to propose the interest rate they would charge on specific borrowings not to exceed \$50 million; however, in no case may the interest rate proposal be greater than the amount provided by the Credit Facility.

Under covenants of the Credit Facility, the Company is required to (i) maintain a balance sheet leverage ratio of less than 0.40 to 1.00, (ii) maintain net income of not less than \$1.00 for each fiscal quarter, (iii) maintain certain cash flow and interest coverage ratios (as defined) of not less than 1.0 to 1.0 and 5.0 to 1.0, respectively and (iv) maintain a minimum total shareholders' equity (as defined). In addition, the Company is limited in its ability to incur additional borrowings (the Company is required to maintain unencumbered assets with an aggregate book value equal to or greater than three times the Company's unsecured recourse debt) or sell assets. The Company was in compliance with the covenants of the Credit Facility at December 31, 1997.

Note 7. Notes Payable

Notes payable at December 31, 1997 and 1996 consist of the following:

(In thousands)	1997		1996	
	Carrying amount	Fair value	Carrying amount	Fair value
7.08% unsecured senior notes, due November 2003	\$53,250	\$ 53,250	\$ 59,750	\$ 59,750
Mortgage notes payable:				
10.55% mortgage notes secured by real estate facilities, principal and interest payable monthly, due August 2004	30,355	34,571	32,115	34,964
7.07% to 11.00% mortgage notes secured by real estate facilities, principal and interest payable monthly, due at varying dates between July 1998 and September 2028	12,953	12,953	16,578	16,578
	\$96,558	\$100,774	\$108,443	\$111,292

During 1995, in connection with the PSMI Merger, the Company assumed the 7.08% unsecured senior notes payable. The senior notes require interest and principal payments to be paid semi-annually and have various restrictive covenants, all of which have been met at December 31, 1997.



The 10.55% mortgage notes consist of five notes which are cross-collateralized by 19 properties and are due to a life insurance company. Although there is a negative spread between the carrying value and the estimated fair value of the notes, the notes provide for the prepayment of principal subject to the payment of penalties which exceed this negative spread. Accordingly, prepayment of the notes at this time would not be economically practicable.

Mortgage notes payable are secured by 26 of the Company's real estate facilities having an aggregate net book value of \$60.5 million at December 31, 1997.

At December 31, 1997, approximate principal maturities of notes payable are as follows:

(In thousands)	7.08% Unsecured Senior Notes	Fixed Rate Mortgage debt (weighted average rate of 9.77%)	Total
1998	\$ 7,250	\$ 7,881	\$15,131
1999	8,000	6,398	14,398
2000	8,750	2,622	11,372
2001	9,500	2,910	12,410
2002	9,750	3,229	12,979
Thereafter	10,000	20,268	30,268
	<u>\$53,250</u>	<u>\$43,308</u>	<u>\$96,558</u>

Interest paid (including interest related to the borrowings on the Credit Facility) during 1997, 1996 and 1995 was \$8,884,000, \$10,312,000 and \$8,595,000, respectively. In addition, in 1997, 1996 and 1995, the Company capitalized interest totaling \$2,428,000, \$1,861,000 and \$307,000, respectively, related to construction of real estate facilities.

Note 8. Minority Interest

In consolidation, the Company classifies ownership interests other than its own in the net assets of each of the Consolidated Entities as minority interest on the consolidated financial statements. Minority interest in income consists of the minority interests' share of the operating results of the Company relating to the consolidated operations of the Consolidated Entities.

During 1997, the Company acquired limited partnership interests in the Consolidated Entities in several transactions for an aggregate cost of \$21,559,000. These transactions had the effect of reducing minority interest by approximately \$12,655,000 (the historical book value of such interests in the underlying net assets of the partnerships). The excess of the cost over the underlying book value (\$8,904,000) has been allocated to real estate facilities in consolidation. In 1996 and 1995, the Company acquired interests in the Consolidated Entities at an aggregate cost of \$15,419,000 and \$32,683,000, respectively, reducing minority interest by approximately \$8,193,000 and \$32,906,000, respectively. The excess of cost over underlying book values was allocated to real estate facilities in consolidation.

During 1997, the Private REIT issued shares of its common stock and the Operating Partnership issued limited partnership units to third parties, primarily in exchange for real estate facilities, increasing minority interest approximately \$117.1 million.

During 1997, 1996 and 1995, in connection with certain business combinations (Note 3) minority interest was increased by \$74,068,000, \$20,139,000 and \$17,034,000, respectively, representing the remaining partners' equity interests in the aggregate net assets of the Consolidated Entities.

Note 9. Property Management and Advisory Contracts

Pursuant to the PSMI Merger, the Company became self-advised and self-managed; accordingly, effective November 16, 1995, the Company no longer incurs either advisory fees or property management fees.

Prior to the PSMI Merger, PSMI provided property operation services for a fee to the Company under a management agreement and an affiliate of PSMI administered the day-to-day investment operations for a fee pursuant to an advisory contract. Pursuant to the management agreement, PSMI or an affiliate of PSMI operated all of the properties in which the Company invested for a fee which is equal to 6% of the gross revenues of the self-storage facilities spaces managed and 5% of the gross revenues of the commercial properties operated. Management fees relating to the Company's real estate facilities, which are included in cost of operations, amounted to \$10,232,000 in 1995. During 1995 (from January 1, 1995 through November 16, 1995), the Company paid advisory fees equal to \$6,437,000 pursuant to the advisory contract.

In connection with the PSMI Merger, the Company acquired property management contracts for (i) self-storage facilities owned by affiliated entities and, to a lesser extent, third parties and (ii) through ownership in a subsidiary, commercial properties. These facilities constitute all of the United States self-storage facilities and commercial properties doing business under the "Public Storage" name and, with the exception of third party properties, all those in which the Company had an interest. At December 31, 1997, the Company managed 1,107 self-storage facilities (894 owned by consolidated facilities, 179 owned by unconsolidated affiliates and 34 owned by third parties) and 63 commercial properties were managed by the Operating Partnership (61 owned by consolidated affiliates and two owned by unconsolidated affiliates).



The property management contracts generally provide for compensation equal to 6%, in the case of the self-storage facilities, and 5%, in the case of the commercial properties, of gross revenues of the facilities managed. Under the supervision of the property owners, the Company coordinates rental policies, rent collections, marketing activities, the purchase of equipment and supplies, maintenance activity, and the selection and engagement of vendors, suppliers and independent contractors. In addition, the Company assists and advises the property owners in establishing policies for the hire, discharge and supervision of employees for the operation of these facilities, including resident managers, assistant managers, relief managers and billing and maintenance personnel.

Note 10. Shareholders' Equity

Preferred stock

At December 31, 1997 and 1996, the Company had the following series of Preferred Stock outstanding:

Series	Dividend Rate	At December 31, 1997		At December 31, 1996	
		Shares Outstanding	Carrying Amount	Shares Outstanding	Carrying Amount
Series A	10.000%	1,825,000	\$ 45,625,000	1,825,000	\$ 45,625,000
Series B	9.200%	2,386,000	59,650,000	2,386,000	59,650,000
Series C	Adjustable	1,200,000	30,000,000	1,200,000	30,000,000
Series D	9.500%	1,200,000	30,000,000	1,200,000	30,000,000
Series E	10.000%	2,195,000	54,875,000	2,195,000	54,875,000
Series F	9.750%	2,300,000	57,500,000	2,300,000	57,500,000
Series G	8.875%	6,900	172,500,000	6,900	172,500,000
Series H	8.450%	6,750	168,750,000	6,750	168,750,000
Series I	8.625%	4,000	100,000,000	4,000	100,000,000
Series J	8.000%	6,000	150,000,000	—	—
Total Senior Preferred Stock		11,129,650	868,900,000	11,123,650	718,900,000
Convertible	8.25%	2,132,334	53,308,000	2,238,975	55,974,000
Mandatory Convertible — Series CC	13.00%	—	—	58,955	58,955,000
Total Convertible Preferred Stock		2,132,334	53,308,000	2,297,930	114,929,000
		13,261,984	\$922,208,000	13,421,580	\$833,829,000

During 1997, the Company issued 6,000,000 depository shares (each representing 1/1,000 of a share) of its 8.00% Series J Preferred Stock (August 25, 1997) raising net proceeds of approximately \$144.9 million.

During 1996, the Company issued 6,750,000 depository shares (each representing 1/1,000 of a share) of its 8.45% Series H Preferred Stock (January 25, 1996) raising net proceeds of approximately \$163.1 million and 4,000,000 depository shares (each representing 1/1,000 of a share) of its 8.625% Series I Preferred Stock (November 1, 1996) raising net proceeds of approximately \$96.7 million.

In April 1996, in connection with the acquisition of limited partnership interests (Note 3), the Company issued \$58,955,000 (58,955 shares) of its Mandatory Convertible Preferred Stock, Series CC (the "Series CC Preferred Stock"). During the second quarter of 1997, all the Series CC Convertible Preferred Stock was converted into 2,184,250 shares of common stock.

The Series A through Series J (collectively the "Cumulative Senior Preferred Stock") have general preference rights with respect to liquidation and quarterly distributions. With respect to the payment of dividends and amounts upon liquidation, all of the Company's Convertible Preferred Stock ranks junior to the Cumulative Senior Preferred Stock and any other shares of preferred stock of the Company ranking on a parity with or senior to the Cumulative Senior Preferred Stock. The Convertible Preferred Stock ranks senior to the common stock, any additional class of common stock and any series of preferred stock expressly made junior to the Convertible Preferred Stock.

Holders of the Company's preferred stock, except under certain conditions and as noted above, will not be entitled to vote on most matters. In the event of a cumulative arrearage equal to six quarterly dividends or failure to maintain a Debt Ratio (as defined) of 50% or less, holders of all outstanding series of preferred stock (voting as a single class without regard to series) will have the right to elect two additional members to serve on the Company's Board of Directors until events of default have been cured. At December 31, 1997, there were no dividends in arrears and the Debt Ratio was 3.1%.

Except under certain conditions relating to the Company's qualification as a REIT, the Senior Preferred Stock are not redeemable prior to the following dates: Series A – September 30, 2002, Series B – March 31, 2003, Series C – June 30, 1999, Series D – September 30, 2004, Series E – January 31, 2005, Series F – April 30, 2005, Series G – December 31, 2000, Series H – January 31, 2001, Series I – October 31, 2001, Series J – August 31, 2002. On or after the respective dates, each of the series of Senior Preferred Stock will be redeemable at the option of the Company, in whole or in part, at \$25 per share (or depository share in the case of the Series H, Series I and Series J), plus accrued and unpaid dividends.



The Convertible Preferred Stock is convertible at any time at the option of the holders of such stock into shares of the Company's common stock at a conversion rate of 1.6835 shares of common stock for each share of Convertible Preferred Stock, subject to adjustment in certain circumstances. On or after July 1, 1998, the Convertible Stock will be redeemable for shares of the Company's common stock at the option of the Company, in whole or in part, at a redemption price of 1.6835 shares of common stock for each share of Convertible Stock (subject to adjustment in certain circumstances), if for 20 trading days within any period of 30 consecutive trading days (including the last trading day of such period), the closing price of the common stock on its principal trading market exceeds \$14.85 per share (subject to adjustment in certain circumstances). The Convertible Preferred Stock is not redeemable for cash.

Common stock

During 1997, 1996 and 1995, the Company issued shares of its common stock as follows:

(Dollar amounts in thousands)	1997		1996		1995	
	Shares	Amount	Shares	Amount	Shares	Amount
Public offerings	6,600,000	\$181,448	6,151,200	\$128,501	5,482,200	\$ 82,068
In connection with mergers (Note 3)	7,681,432	212,000	8,839,181	204,932	36,113,800	573,756
Issuance costs of mergers	—	—	—	—	—	(2,527)
Exercise of stock options	94,786	1,075	100,663	1,037	46,670	403
Issuance to affiliates	—	—	43,197	1,000	40,000	582
Conversion of Mandatory Convertible Preferred Stock	—	—	1,611,265	27,960	—	—
Conversion of Series CC Convertible Preferred Stock	2,184,250	58,955	—	—	—	—
Acquisition of interests in real estate entities	—	—	—	—	257,067	4,034
Acquisition of real estate facilities (Note 4)	—	—	—	—	747,355	10,598
Conversion of 8.25% Convertible Preferred Stock	179,651	2,666	102,721	1,526	—	—
	16,740,119	\$456,144	16,848,227	\$364,956	42,687,092	\$668,914

Shares of common stock issued to affiliates in 1996 and 1995 were issued for cash. All the shares of common stock, with the exception of the shares issued in connection with the exercise of stock options, were issued at the prevailing market price at the time of issuance.

At December 31, 1997, the Company had 5,155,238 shares of common stock reserved in connection with the Company's stock option plans (Note 11) and 10,589,662 shares of common stock reserved for the conversion of the Convertible Preferred Stock and the Class B Common Stock.

From January 1, 1998 through March 2, 1998, the Company issued approximately 6.4 million shares of Common Stock raising an aggregate of approximately \$189 million. The Company intends to use the net proceeds from this offering to make investments in real estate and fund the activities of its portable self-storage operations.

Class B common stock

The Class B Common Stock was issued in connection with the PSMI Merger. Under the terms of the merger agreement, the issuance of the Class B Common Stock was subject to certain conditions which were satisfied in December 1995 and the Class B Common Stock was issued on January 2, 1996. The Company has reflected the Class B Common Stock as outstanding as of December 31, 1995.

The Class B Common Stock will (i) not participate in distributions until the later to occur of funds from operations ("FFO") per Common Share as defined below, aggregating \$1.80 during any period of four consecutive calendar quarters, or January 1, 2000; thereafter, the Class B Common Stock will participate in distributions (other than liquidating distributions), at the rate of 97% of the per share distributions on the Common Stock, provided that cumulative distributions of at least \$0.22 per quarter per share have been paid on the Common Stock, (ii) not participate in liquidating distributions, (iii) not be entitled to vote (except as expressly required by California law) and (iv) automatically convert into Common Stock, on a share for share basis, upon the later to occur of FFO per Common Share aggregating \$3.00 during any period of four consecutive calendar quarters or January 1, 2003.

For these purposes FFO means net income (loss) (computed in accordance with generally accepted accounting principles) before (i) gain (loss) on early extinguishment of debt, (ii) minority interest in income and (iii) gain (loss) on disposition of real estate, adjusted as follows: (i) plus depreciation and amortization (including the Company's pro-rata share of depreciation and amortization of unconsolidated equity interests and amortization of assets acquired in the Merger, including property management agreements and goodwill), and (ii) less FFO attributable to minority interest. For these purposes, FFO per Common Share means FFO less preferred stock dividends (other than dividends on convertible preferred stock) divided by the outstanding weighted average shares of Common Stock assuming conversion of all outstanding convertible securities and the Class B Common Stock.

For these purposes, FFO per share of Common Stock (as defined) was \$1.85 for the year ended December 31, 1997.



Equity Stock

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

In June 1997, the Company contributed \$22,500,000 (225,000 shares) of its Equity Stock, Series A ("Equity Stock") to a partnership in which the Company is the general partner. As a result of this contribution, the Company obtained a controlling interest in the Partnership and began to consolidate the accounts of the Partnership and therefore the equity stock is eliminated in consolidation. The Equity Stock ranks on a parity with Common Stock and junior to the Company's Cumulative Senior Preferred Stock and Convertible Preferred Stock with respect to general preference rights and has a liquidation amount of 10 times the amount paid to each Common Share up to a maximum of \$100 per share. Quarterly distributions per share on the Equity Stock are equal to the lesser of (i) 10 times the amount paid per Common Stock or (ii) \$2.20.

Dividends

The characterization of dividends for Federal income tax purposes is made based upon earnings and profits of the Company, as defined by the Internal Revenue Code. Distributions declared by the Board of Directors (including distributions to the holders of preferred stock) in 1997, 1996 and 1995 were characterized as ordinary income.

The following summarizes dividends paid during 1997, 1996 and 1995 (with the exception of the Series G Preferred Stock distributions which were accrued and unpaid at December 31, 1995):

(In thousands, except per share data)	1997		1996		1995	
	Per share	Total	Per share	Total	Per share	Total
Series A	\$ 2.500	\$ 4,563	\$ 2.500	\$ 4,563	\$ 2.500	\$ 4,563
Series B	2.300	5,488	2.300	5,488	2.300	5,488
Series C	1.844	2,213	1.840	2,212	1.970	2,364
Series D	2.375	2,850	2.375	2,850	2.375	2,850
Series E	2.500	5,488	2.500	5,488	2.292	5,030
Series F	2.437	5,606	2.437	5,606	1.618	3,721
Series G	2.219	15,309	2.219	15,479	0.092	638
Series H	2.112	14,259	1.978	13,348	—	—
Series I	2.156	8,625	0.359	1,438	—	—
Series J	0.689	4,133	—	—	—	—
Convertible	2.062	4,531	2.063	4,679	2.063	4,744
Series CC	260.000	15,328	97.500	5,748	—	—
Mandatory Convertible Participating	—	—	54.487	1,700	55.322	1,726
		88,393		68,599		31,124
Common	\$ 0.880	86,181	\$ 0.880	67,709	\$ 0.880	38,586
		\$174,574		\$136,308		\$69,710

The dividend rate on the Series C Preferred Stock is adjusted quarterly and is equal to the highest of one of three U.S. Treasury indices (Treasury Bill Rate, Ten Year Constant Maturity Rate, and Thirty Year Constant Maturity Rate) multiplied by 110%. However, the dividend rate for any dividend period will not be less than 6.75% per annum nor greater than 10.75% per annum. The dividend rate with respect to the first quarter of 1998 will be equal to 6.75% per annum.

The Mandatory Convertible Participating Preferred Stock was issued in connection with the acquisition of all of the limited partnership interests in a real estate limited partnership in 1995. Dividends with respect to the Mandatory Convertible Participating Preferred Stock varied depending on operating results of the underlying real estate facilities of the partnership. During June 1996, the Mandatory Convertible Participating Preferred Stock was exchanged for common stock of the Company.

Note 11. Stock Options

The Company has a 1990 Stock Option Plan (which was adopted by the Board of Directors in 1990 and approved by the shareholders in 1991) (the "1990 Plan") which provides for the grant of non-qualified stock options. The Company has a 1994 Stock Option Plan (which was adopted by the Board of Directors and approved by the shareholders in 1994) (the "1994 Plan") and a 1996 Stock Option and Incentive Plan (which was adopted by the Board of Directors and approved by the shareholders in 1996 (the "1996 Plan"), each of which provides for the grant of non-qualified options and incentive stock options. (The 1990 Plan, the 1994 Plan and the 1996 Plan are collectively referred to as the "Plans"). Under the Plans, the Company has granted non-qualified options to certain directors, officers and key employees and service providers to purchase shares of the Company's common stock at a price equal to the fair market value of the common stock at the date of grant. Generally, options under the Plans vest over a three-year period from the date of grant at the rate of one-third per year and expire



(i) under the 1990 Plan, five years after the date they became exercisable and (ii) under the 1994 Plan and 1996 Plan, ten years after the date of grant. The 1996 Plan also provides for the grant of restricted stock to officers, key employees and service providers on terms determined by the Audit Committee of the Board of Directors; no shares of restricted stock have been granted.

Information with respect to the Plans during 1997 and 1996 is as follows:

	1997		1996	
	Number of Options	Average Price per Share	Number of Options	Average Price per Share
Options outstanding January 1	1,752,169	\$19.02	693,667	\$13.61
Granted	111,000	28.59	1,183,000	21.39
Exercised	(94,786)	11.34	(100,663)	10.29
Canceled	(72,168)	20.73	(23,835)	16.02
Options outstanding December 31	1,696,215	\$20.03	1,752,169	\$19.02
Option price range at December 31	\$8.125 to \$30.00		\$8.125 to \$25.875	
Options exercisable at December 31	778,012	\$17.74	367,947	\$13.05
Options available for grant at December 31	3,459,003		3,497,835	

In 1996, the Company adopted the disclosure requirement provision of SFAS 123 in accounting for stock-based compensation issued to employees. As of December 31, 1997 and 1996, there were 1,412,734, and 1,391,500 options outstanding, respectively, that were subject to SFAS 123 disclosure requirements. The fair value of these options was estimated utilizing prescribed valuation models and assumptions as of each respective grant date. Based on the results of such estimates, management determined that there was no material effect on net income or earnings per share for the years ended December 31, 1997 and 1996. The remaining contractual lives were 7.9 years and 8.6 years, respectively, at December 31, 1997 and 1996.

Note 12. Events Subsequent to December 31, 1997

On January 21, 1998, the Private REIT entered into an agreement with a group of unaffiliated institutional investors under which it would issue up to \$155,000,000 of common stock. An initial \$50,000,000 of common stock was issued on January 21, 1998 upon the closing of the transaction. The remaining \$105,000,000 of common stock will be issued as funds are required to purchase commercial properties.

In connection with the merger of the Private REIT into Public Storage Properties XI, Inc. on March 17, 1998 (the surviving entity renamed PS Business Parks, Inc. – “PSBP”). PSBP exchanged 13 self-storage facilities for 11 commercial properties owned by the Company. Upon completion of the merger, the Company and its Consolidated Entities owned approximately 58% of PSBP and the Operating Partnership on a combined basis.

As a result of the March 17, 1998 merger and the agreement to issue additional shares of common stock to the group of unaffiliated institutional investors, the Company believes that its reduced ownership will no longer warrant the consolidation of these entities effective March 31, 1998. The Company's consolidated financial statements include the following summarized condensed financial data associated with the consolidation of PSBP and the Operating Partnership:

(In thousands)	1997
Year ended December 31,	
Rental income	\$ 30,169
Total revenues	\$ 31,578
Cost of operations	\$ 12,519
Depreciation	\$ 6,973
Net income before minority interest	\$ 10,623
Net income after minority interest	\$ 9,247
At December 31,	
Total assets, net of accumulated depreciation	\$344,706
Total minority interest	\$117,731
Total net assets before minority interest	\$335,904

In February 1998, Public Storage Properties XX, Inc. (“Properties 20”) agreed, subject to certain conditions, to merge with and into the Company. Properties 20 is an affiliated publicly traded equity REIT. The merger is conditioned on approval by the shareholders of Properties 20. The estimated value of the Properties 20 merger is approximately \$23.3 million. Properties 20 owns seven self-storage facilities (approximately 402,000 square feet) located in five states. At December 31, 1997, the Company owned approximately 24% of Properties 20. The Company expects that, if approved by the Properties 20 shareholders, the merger would be completed in the second quarter of 1998.

**Note 13. Recent Accounting Pronouncements**

In June 1997, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards No. 130, "Reporting Comprehensive Income" ("FAS 130"), which establishes standards for reporting and display of comprehensive income and its components. This statement requires a separate statement to report the components of comprehensive income for each period reported. The provisions of this statement are effective for fiscal years beginning after December 15, 1997. The Company will implement FAS 130 for the fiscal year ended December 31, 1998, but the Company does not expect the impact of FAS 130 to be material.

In July 1997, the FASB issued Statement of Financial Accounting Standards No. 131, "Disclosures about Segments of an Enterprise and Related Information" ("FAS 131"), which establishes standards for the way that public business enterprises report information about operating segments in annual financial statements and requires that those enterprises report selected information about operating segments in interim financial reports issued to shareholders. This statement is effective for financial statements for periods beginning after December 15, 1997. Management does not expect FAS 131 to have a significant impact upon the Company's reporting presentation.

Note 14. Commitments and Contingencies**Lease obligations**

Each of the 49 facilities operated by PSPUD as of December 31, 1997 are located in buildings leased from third parties. The lease terms range from four to nine years with renewal options at varying terms. Future minimum lease payments at December 31, 1997 under noncancelable operating leases are as follows:

(in thousands)	
1998	\$11,413
1999	10,752
2000	10,313
2001	9,633
2002	6,336
Thereafter	3,135
Total	\$51,582

Legal proceedings

During 1997, three cases were filed against the Company. Each of the plaintiffs in these cases is suing the Company on behalf of a purported class of California tenants who rented storage spaces from the Company and contends that the Company's fees for late payments under its rental agreements for storage space constitutes unlawful "penalties" under California law. None of the plaintiffs has assigned any dollar amount to the claims.

The lower court has dismissed one of the cases and the plaintiff in that case is in the process of appealing that dismissal. The plaintiffs in the other two cases have voluntarily dismissed their cases, reserving their rights to refile their cases. The Company is continuing to vigorously contest the claims in all three cases.

There are no other material proceedings pending against the Company or any of its subsidiaries.

Note 15. Supplementary Quarterly Financial Data (Unaudited)

(In thousands, except per share data)	Three months ended			
	March 31, 1997	June 30, 1997	September 30, 1997	December 31, 1997
Revenues	\$100,740	\$109,362	\$126,008	\$134,734
Net income	\$ 42,318	\$ 44,251	\$ 46,548	\$ 45,532
Per Common Share (Note 2):				
Net income — Basic	\$0.26	\$0.14 ⁽¹⁾	\$0.27	\$0.24
Net income — Diluted	\$0.26	\$0.14 ⁽¹⁾	\$0.27	\$0.24

(In thousands, except per share data)	Three months ended			
	March 31, 1996	June 30, 1996	September 30, 1996	December 31, 1996
Revenues	\$74,527	\$82,688	\$87,518	\$94,218
Net income	\$32,341	\$37,739	\$40,366	\$43,103
Per Common Share (Note 2):				
Net income — Basic	\$0.24	\$0.27	\$0.30	\$0.29
Net income — Diluted	\$0.24	\$0.27	\$0.30	\$0.29

(1) Includes the effect of a \$13,412,000 special dividend on the Company's Series CC Convertible Preferred Stock.

Revenues for each of the three-month periods in 1997 and 1996 reflect reclassification to conform with the fiscal 1997 presentation. The 1996 and the first three quarters of 1997 earnings per share amounts have been restated to comply with Statement of Financial Accounting Standards 128 – Earnings Per Share.



Report of Independent Auditors

The Board of Directors and Shareholders
Public Storage, Inc.

We have audited the accompanying consolidated balance sheets of Public Storage, Inc. as of December 31, 1997 and 1996, and the related consolidated statements of income, shareholders' equity, and cash flows for each of the three years in the period ended December 31, 1997. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Public Storage, Inc. at December 31, 1997 and 1996, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 1997, in conformity with generally accepted accounting principles.

Los Angeles, California

February 23, 1998, except for Notes 10 and 12,
as to which the date is March 17, 1998



Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion and analysis should be read in conjunction with the Company's consolidated financial statements and notes thereto.

Overview:

The self-storage industry is highly fragmented and is composed predominantly of numerous local and regional operators. Competition in the markets in which the Company operates is significant and is increasing from additional development of self-storage facilities in many markets which may negatively impact occupancy levels and rental rates at the Company's self-storage facilities. However, the Company believes it possesses several distinguishing characteristics which enable it to compete effectively with other owners and operators.

The Company believes it is the largest owner and operator of self-storage facilities in the United States with ownership interests in 1,073 self-storage facilities containing approximately 64 million net rentable square feet. All of the Company's facilities are operated under the "Public Storage" brand name, which the Company believes is the most recognized and established name in the self-storage industry. Located in the major metropolitan markets of 37 states, the Company's self-storage facilities are geographically diverse, giving it national recognition and prominence. This concentration establishes the Company as one of the dominant providers of storage space in each market that it operates in and enables it to use a variety of promotional activities, such as television and radio advertising as well as targeted discounting and referrals, which are generally not economically viable for its competitors. In addition, the Company believes that geographic diversity of the portfolio reduces the impact from regional economic downturns and provides a greater degree of revenue stability.

In an effort to attract a wider variety of customers, to further differentiate the Company from its competition and to generate new sources of revenue, additional products are being offered to enhance the Company's self-storage business. In late 1996, the Company organized Public Storage Pickup and Delivery, Inc. as a separate corporation and a related partnership (the corporation and partnership are collectively referred to as "PSPUD") to operate a portable self-storage business that rents storage containers to customers for storage in central warehouses. The concept of PSPUD is to provide an alternative to a traditional self-storage facility wherein customers transport their goods to the facility and rent a space to store their goods. PSPUD will deliver a storage container(s) to the customer's location where the customer, at his convenience, packs his goods into the storage container. PSPUD will subsequently return to the customer's location to retrieve the storage container(s) for storage in a central warehouse. PSPUD is not intended to replace the traditional self-storage facility but is designed to complement and provide additional services to the customers not offered at the self-storage facilities.

During 1997, PSPUD opened 45 facilities, which combined with facilities opened as of the beginning of the year brought the total number of facilities to 49. The facilities are located in 24 greater metropolitan areas in 16 states. Averaging approximately 2,000 containers per facility, a facility provides approximately 70,000 net rentable square feet which is slightly larger than an average self-storage facility which contains approximately 65,000 net rentable square feet. Currently, all of the PSPUD facilities operate in facilities leased from third parties which has provided the Company with an efficient and flexible means of expanding rapidly into markets.

At December 31, 1997, the PSPUD facilities in aggregate had 36,000 occupied containers, representing approximately 1,256,000 square feet. The Company believes that, to some extent, the portable self-storage business may negatively impact the occupancy levels of self-storage facilities located in the same markets. However, the Company's average self-storage occupancy level is higher than at any comparable period in prior years, despite the promotion and rental activity of the portable self-storage business in the same markets. In the Los Angeles, California market, for example, where the Company has operated a consistent pool of 138 self-storage facilities since 1993, the occupancy levels of these facilities increased from 87.8% (7.3 million occupied square feet) at January 31, 1997 to 93.1% (7.7 million occupied square feet) at January 31, 1998, representing an increase of approximately 5.3%. During the same period of time, the newly opened PSPUD facilities in the Los Angeles market increased their aggregate occupied containers from 957 (33,495 square feet) at January 1997 to 8,830 (309,050 square feet) at January 1998. Accordingly, in aggregate (self-storage and portable self-storage combined), occupied square footage increased from 7.3 million at January 31, 1997 to 8.0 million at January 31, 1998, representing an increase of approximately 700,000 square feet. The Company is seeking to replicate this performance in other major markets in which it operates. However, there can be no assurance that the Company will be successful.



Due to the start-up nature of the new business venture, PSPUD generated operating losses which materially impacted the Company's earnings in 1997 and is expected to continue to generate losses during 1998. The Company, however, continues to believe that it should invest in PSPUD, which responds to a promising business opportunity in at least certain markets and complements the Company's existing self-storage operations through joint use of a national telephone reservation system and a coordinated media advertising program designed to increase consumer awareness and rental activity of both traditional self-storage facilities and portable self-storage.

One of the keys to the successful operation of self-storage and portable self-storage businesses has been and will continue to be the national telephone reservation system. Commencing in early 1996, the Company implemented a national telephone reservation system designed to provide added customer service. Customers calling either the Company's toll-free telephone referral system, (800) 44-STORE, or a self-storage facility are directed to the national reservation system where a representative discusses with the customer space requirements, price and location preferences and also informs the customer of other products and services provided by the Company and its subsidiaries. The national telephone reservation system was not fully operational for most of the Company's facilities until the latter part of the fourth quarter of 1996. Currently, the national telephone reservation system receives approximately 160,000 calls per month and has approximately 200 representatives. The Company believes that the national telephone reservation system permits effective marketing for both self-storage and portable self-storage facilities and is primarily responsible for increasing occupancy levels and realized rental rates experienced at the self-storage facilities during 1997 compared to the same period in the prior year.

The Company will continue to focus its growth strategies on: (i) improving the operating performance of its existing portfolio of properties, (ii) increasing its ownership of self-storage facilities through acquisitions of facilities owned by affiliates or third party owners, (iii) development of new self-storage facilities, (iv) expansion and improvement of the operations of PSPUD, and (v) to a limited extent through its existing ownership interest, will participate in the growth of PS Business Parks, Inc., a publicly traded real estate investment trust focusing on the ownership and operation of commercial properties.

The Company seeks to increase the operating performance of its existing portfolio of properties by (i) increasing average occupancy rates and (ii) achieving higher levels of realized monthly rents per occupied square foot. The Company believes that its property management personnel and systems combined with the national telephone reservation system and marketing programs will enhance the Company's ability to meet these goals.

In addition to 533 wholly owned self-storage facilities, the Company also operates, on behalf of approximately 64 ownership entities in which the Company has a partial equity interest, 540 self-storage facilities under the "Public Storage" name. From time to time, some of these self-storage facilities or interests in them are available for purchase, providing the Company with a source of additional acquisition opportunities. The Company believes these properties include some of the better located, better constructed self-storage facilities in the industry. Because these properties are partially owned by the Company, it is provided with reliable operating information prior to acquisition and these properties are easily integrated into the Company's portfolio. During 1996 and 1997, the Company acquired 100 and 99 self-storage facilities from affiliated entities in connection with mergers, respectively, and increased its ownership interest in 54 and 69 self-storage facilities by acquiring additional interests in affiliated partnerships owning self-storage facilities, respectively. During 1996 and 1997, the Company acquired 47 and 4 self-storage facilities from third parties, respectively. Similar to 1997, the Company does not expect third party acquisitions to be significant during fiscal 1998, unless attractive investment opportunities are available.

Since 1995, the Company has developed and opened a total of seven self-storage facilities, one in 1995, four in 1996, and two in 1997. At December 31, 1997, four self-storage facilities and ten portable self-storage facilities were under construction. Since April 1997, the Company's development activity with respect to the self-storage facilities, has been concentrated in a joint venture partnership between the Company and a major state pension plan. Under the joint venture arrangement, the state pension plan contributes 70% of the equity with the remaining 30% of the equity being provided by the Company to finance development. There is no debt included in the partnership and the Company, after a specified period of time, has an option to acquire the state pension plan's interest in the partnership. Due to the Company's non-controlling ownership interest, the joint venture partnership is not consolidated in the Company's financial statements. The partnership is expected to develop up to \$220 million of properties (approximately 50 facilities) with expected store openings through mid-1999. During 1997, the joint venture developed and opened seven self-storage facilities (approximately 412,000 square feet) and had 17 facilities under development (approximately 1,169,000 square feet).



The feasibility of developing additional self-storage and portable self-storage facilities is ongoing. The focus is on selected markets in which there are few, if any, facilities to acquire at attractive prices and where the scarcity of other undeveloped parcels of land or other impediments to development make it difficult to construct additional competing facilities.

In January and February 1998, PSPUD opened five additional facilities. PSPUD is currently developing 10 facilities and has also identified an additional five sites for development which collectively have an aggregate estimated cost of \$67.5 million. All such facilities are located in existing markets in which PSPUD currently operates.

On January 2, 1997, the Company reorganized its commercial property operations into a separate private REIT. The private REIT contributed its assets to a newly created operating partnership (the "Operating Partnership") in exchange for a general partnership interest and limited partnership interests. The Company and certain partnerships in which the Company has a controlling interest contributed substantially all of their commercial properties to either the Operating Partnership in exchange for limited partnership interests or to the private REIT in exchange for common stock. The Company believes that the concentration of all the commercial properties and the property manager into one entity will create a vehicle which should facilitate future growth in this segment of the real estate industry. The Company will participate in the entity's growth through the Company's ownership interest.

In 1997, the private REIT and Operating Partnership acquired 10 commercial properties from third parties. The aggregate purchase price of these facilities consisted of cash, common stock of the private REIT and limited partnership interests of the Operating Partnership.

At December 31, 1997, the private REIT and the Operating Partnership owned 49 properties located in 10 states. The Operating Partnership also managed the commercial properties owned by the Company and affiliated entities. As of December 31, 1997, the Company owned approximately 53% of the private REIT which owned approximately 19% of the Operating Partnership. The balance of the Operating Partnership is primarily owned by the Company and partnerships controlled by the Company.

On January 21, 1998, the private REIT entered into an agreement with a group of unaffiliated institutional investors under which up to \$155,000,000 in common stock would be issued. \$50,000,000 of this common stock was issued on January 21, 1998, with the remainder to be issued as funds are required to purchase commercial properties.

On March 17, 1998, the private REIT merged into Public Storage Properties XI, Inc., a publicly traded REIT and an affiliate of the Company, and the name of the surviving corporation was changed to PS Business Parks, Inc. ("PSBP"). In connection with the merger, PSBP exchanged 13 self-storage facilities for 11 commercial properties owned by the Company. Upon completion of the merger, PSBP and the Operating Partnership owned 64 commercial properties (approximately 7.3 million square feet), and managed the commercial properties owned by the Company and affiliated partnerships. Upon completion of the merger, the Company and partnerships controlled by the Company owned approximately 58% of PSBP and the Operating Partnership on a combined basis.

Due to the Company's controlling ownership interest in PSBP and the Operating Partnership, the Company included the operations of these entities in the Company's consolidated financial statements as of December 31, 1997. However, as a result of the March 17, 1998 merger and the agreement to issue additional shares of common stock to the group of unaffiliated institutional investors, the Company believes that its reduced ownership will no longer warrant consolidation of these entities effective March 31, 1998.

Since 1994, the Company has significantly increased both its asset and capital base through the investment in additional real estate assets financed predominantly with the issuance of equity. As a result, the increased asset base has translated into significant growth in the Company's overall operating results. The comparative growth in operating results between 1997 and 1996 is principally due to mergers with affiliated REITs combined with acquisitions of additional real estate facilities and investments in real estate entities. The comparative growth in operating results between 1996 and 1995 is principally due to the impact of the Company's merger with Public Storage Management, Inc. ("PSMI"), whereby the Company became self-administered and self-managed and acquired substantially all of the United States real estate operations of PSMI (the "PSMI Merger").



Results of Operations

Net income and earnings per common share: Net income for 1997, 1996 and 1995 was \$178,649,000, \$153,549,000 and \$70,386,000, respectively, representing increases over the prior year of 16.4% for 1997 and 118.2% for 1996. Net income allocable to common shareholders (net income less preferred stock dividends) for 1997, 1996 and 1995 was \$90,256,000, \$84,950,000 and \$39,262,000, respectively, representing increases over the prior year of 6.3% for 1997 and 116.4% for 1996. On a diluted basis, net income per common share was \$0.91 (based on weighted average shares outstanding of 98,961,000) for 1997, \$1.10 per common share (based on weighted average shares outstanding of 77,358,000) for 1996 and \$0.95 per common share (based on weighted average shares outstanding of 41,171,000) for 1995.

The decrease in net income per share for 1997 compared to 1996 was principally the result of losses generated from PSPUD's portable self-storage business which generated operating losses totaling \$31,665,000 or \$0.32 per common share and the effect of the special dividend, discussed below. The increase in net income per share for 1996 compared to 1995 was principally the result of improved real estate operations, partially offset by the operating losses generated by PSPUD's portable self-storage business totaling \$826,000 or \$0.01 per common share.

Net income allocable to common shareholders and net income per common share for the year ended December 31, 1997 was negatively impacted by a special dividend totaling \$13,412,000, paid on the Company's Series CC Convertible Preferred Stock ("Series CC") during the first quarter of 1997. As a result of this special dividend, the Company would not have been required to pay another dividend with respect to this stock until the quarter ended March 31, 1999. During the second quarter of 1997, the Series CC stock converted into common stock of the Company. Accordingly during 1997, all of the \$13,412,000 (\$0.14 per common share, on a diluted basis) of dividends were treated as an allocation of net income to the preferred shareholders in determining the allocation of net income to the common shareholders. The special dividend eliminated the quarterly dividend of \$1.9 million (annual fixed charges of \$7.6 million).

Net income includes depreciation and amortization expense (including depreciation included in equity in earnings of real estate entities) of approximately \$93,585,000 (\$0.95 per common share) for 1997, \$70,927,000 (\$0.92 per common share) for 1996 and \$31,562,000 (\$0.77 per common share) for 1995. The fiscal 1995 earnings per common share also includes a reduction of approximately \$0.08 per common share relating to the accrual of estimated environmental remediation costs (discussed below).

Real Estate Operations

At December 31, 1997, the Company's investment portfolio consisted of (i) its wholly-owned properties, (ii) properties owned by real estate entities consolidated with the Company (the "Consolidated Entities") and (iii) properties owned by real estate entities in which the Company's ownership interest and control are not sufficient to warrant the consolidation of such entities (the "Unconsolidated Entities"). The following table summarizes the Company's investment in real estate facilities as of December 31, 1997:

	Number of Facilities in which the Company has an ownership interest			Net Rentable Square Footage (In thousands)		
	Self-storage facilities	Commercial properties	Total	Self-storage facilities	Commercial properties	Total
Wholly-owned facilities	533	12	545	32,635	652	33,287
Facilities owned by Consolidated Entities	361	49	410	20,936	6,035	26,971
Total consolidated facilities	894	61	955	53,571	6,687	60,258
Facilities owned by Unconsolidated Entities	179	2	181	10,453	191	10,644
Total facilities in which the Company has an ownership interest	1,073	63	1,136	64,024	6,878	70,902



Self-storage operations: The self-storage operations is by far the largest component of the Company's operations, representing approximately 82% of total revenues generated during 1997. At the beginning of 1994, the Company had a total of 368 self-storage facilities included in its consolidated financial statements. Since that time, the Company through acquisition and development activities has increased the number of self-storage facilities by 526 (1995 – 152 facilities, 1996 – 201 facilities and 1997 – 173 facilities). Self-storage rental income and cost of operations presented on the consolidated statements of income reflect the operations of all the 894 self-storage facilities owned by the Company and the Consolidated Entities. For year to year comparisons, the following table summarizes the operating results (before depreciation) of those facilities owned throughout each of the past three years and those acquired during the past three years:

Self-Storage Operations:

(Dollar amounts in thousands, except rents per square foot)	Year Ended December 31,			Year Ended December 31,		
	1997	1996	Percentage Change	1996	1995	Percentage Change
Rental income:						
Consistent group	\$162,376	\$153,566	5.7%	\$153,566	\$147,178	4.3%
Post-1994 acquisitions	223,164	116,863	91.0%	116,863	36,922	216.5%
	385,540	270,429	42.6%	270,429	184,100	46.9%
Cost of operations:						
Consistent group	49,392	47,317	4.4%	47,317	50,960	(7.2)%
Post-1994 acquisitions	68,571	35,177	94.9%	35,177	12,436	182.9%
	117,963	82,494	43.0%	82,494	63,396	30.1%
Net operating income:						
Consistent group	112,984	106,249	6.3%	106,249	96,218	10.4%
Post-1994 acquisitions	154,593	81,686	89.3%	81,686	24,486	233.6%
	\$267,577	\$187,935	42.4%	\$187,935	\$120,704	55.7%
Consistent group data:						
Gross margin	69.6%	69.2%	0.4%	69.2%	65.4%	3.8%
Weighted average occupancy	90.9%	90.3%	0.6%	90.3%	89.3%	1.0%
Average realized annual rent per occupied square foot	\$8.28	\$7.92	4.6%	\$7.92	\$7.68	3.1%
Average scheduled annual rent per square foot	\$8.76	\$8.04	9.0%	\$8.04	\$7.44	8.1%
Number of facilities (at the end of the period):						
Consistent group	368	368	—	368	368	—
Cumulative post-1994 acquisitions	526	353	49.0%	353	152	132.2%
Net rentable square feet (at the end of the period):						
Consistent group	21,662	21,662	—	21,662	21,662	—
Cumulative post-1994 acquisitions	31,909	21,755	46.7%	21,755	9,116	138.7%

For the consistent group of facilities owned throughout each of the three fiscal years, year-over-year improvements in rental income of 5.7% in 1997 and 4.3% in 1996 are the result of increased realized rent per square foot and increased weighted average occupancy levels, as reflected in the table above. The Company believes that the improvement in each of these areas is due to (i) the national telephone reservation system which was implemented during 1996 and the first part of 1997, (ii) increased rental rates put into effect during the second half of 1996, and (iii) media advertising implemented during the second half of 1997.

As indicated above, the Company implemented a national telephone reservation system to provide added customer service. Customers calling either the Company's toll-free telephone referral system, (800) 44-STORE, or a local Public Storage facility, are directed to the national reservation system where a trained representative discusses with the customer space requirements, price and location preferences and also informs the customer of other products and services provided by the Company and its subsidiaries.



In the second half of 1996, the Company began to increase its scheduled rents charged to new customers (prior to promotional discounts) and to existing tenants where warranted. As a result, for fiscal 1997, scheduled rents per square foot increased compared to 1996. In connection with the national telephone reservation system, the Company experimented with pricing and promotional discounts designed to increase rental activity. Accordingly, promotional discounts (which are included as a reduction to gross rents to arrive at rental income) increased significantly from \$303,000 in 1995 to \$4,031,000 in 1996 and \$14,244,000 in 1997. Despite the increased discounts, the Company's facilities experienced increased realized rents per square foot of 4.6% in 1997 compared to 1996 and 3.1% in 1996 compared to 1995.

With the exception of property management fees, most of the self-storage operating costs (i.e. payroll, property taxes, repairs and maintenance, etc.) are generally fixed. As a result of becoming self-managed in connection with the PSMI Merger, the Company no longer incurs property management fees. Cost of operations for 1996 decreased compared to 1995 principally as a result of the elimination of property management fees for 1996. Included in cost of operations for 1995 were management fees totaling \$9,421,000. However, offsetting the decrease in property management fees in 1997 and 1996 are expenses with respect to the national telephone reservation system totaling \$3,875,000 and \$1,257,000, respectively.

Development of self-storage facilities: Commencing in 1995, the Company began to construct self-storage facilities. Through December 31, 1997, the Company constructed and opened for operation seven facilities, one of which began operations in August 1995 (approximately 64,000 net rentable square feet), four in 1996 (approximately 244,000 net rentable square feet) and two in 1997 (approximately 118,000 net rentable square feet). At December 31, 1997, the Company had four self-storage facilities (approximately 273,000 net rentable square feet) under construction with an aggregate cost incurred to date of approximately \$10.3 million and total additional estimated cost to complete of \$14.6 million. Generally, the construction period takes 9 to 12 months followed by an 18 to 24 month fill-up process until the newly constructed facility reaches an stabilized occupancy level of approximately 90%.

In April 1997, the Company formed a joint venture partnership with a state pension fund to participate in the development of approximately \$220 million of self-storage facilities. The Company expects that substantially all of its development activities will be conducted in the joint venture partnership until the \$220 million is fully committed. At December 31, 1997, the joint venture partnership had completed construction on seven self-storage facilities (approximately 412,000 net rentable square feet) with a total cost of approximately \$40.8 million, and had 17 facilities under construction (approximately 1,169,000 net rentable square feet) with an aggregate cost incurred to date of approximately \$48.9 million and total additional estimated cost to complete of \$29.3 million. The partnership is funded solely with equity capital consisting of 30% from the Company and 70% from the state pension fund. The Company accounts for its investment in the joint venture partnership using the equity method. The following summarizes selected financial data of the development joint venture partnership:

(In thousands)	
Period from inception (April 10, 1997) to December 31, 1997	
Rental income	\$ 952
Total revenues	\$ 1,125
Cost of operations	\$ 664
Depreciation	\$ 456
Net loss	\$ (22)
At December 31, 1997	
Construction in progress	\$48,888
Total assets	\$96,076
Total equity	\$91,184



Commercial property operations: The Company's commercial property operations represent approximately 9% of the Company's operations (based on total revenues generated during 1997). The commercial properties are generally composed of multi-tenant office/industrial space and to a lesser extent suburban office. Commercial property rental income and cost of operations presented on the consolidated statements of income reflect the operations of the 61 facilities owned by the Company and the Consolidated Entities. The following table summarizes the operating results (before depreciation) of these facilities for each of the past three years:

Commercial Property Operations:

(Dollar amounts in thousands, except rents per square foot)	Year Ended December 31,			Year Ended December 31,		
	1997	1996	Percentage Change	1996	1995	Percentage Change
Rental income:						
Consistent group	\$17,723	\$17,117	3.5%	\$17,117	\$16,974	0.8%
Post-1994 acquisitions	22,852	6,459	253.8%	6,459	1,060	509.3%
	40,575	23,576	72.1%	23,576	18,034	30.7%
Cost of operations:						
Consistent group	8,018	8,046	(0.3)%	8,046	8,326	(3.4)%
Post-1994 acquisitions	8,647	2,704	219.8%	2,704	525	415.0%
	16,665	10,750	55.0%	10,750	8,851	21.5%
Net operating income:						
Consistent group	9,705	9,071	7.0%	9,071	8,648	4.9%
Post-1994 acquisitions	14,205	3,755	278.3%	3,755	535	601.9%
	\$23,910	\$12,826	86.4%	\$12,826	\$ 9,183	39.7%
Consistent group data:						
Gross margin	54.8%	53.0%	3.6%	53.0%	51.0%	2.0%
Weighted average occupancy	95.5%	96.0%	(0.5)%	96.0%	95.9%	0.1%
Average realized annual rent per square foot	\$ 9.12	\$ 8.76	4.1%	\$ 8.76	\$ 8.64	1.4%
Number of facilities (at the end of the period):						
Consistent group	17	17	—	17	17	—
Cumulative post-1994 acquisitions	44	18	144.4%	18	3	500.0%
Net rentable square feet (at the end of the period):						
Consistent group	1,925	1,925	—	1,925	1,925	—
Cumulative post-1994 acquisitions	4,762	1,120	325.2%	1,120	79	1,317.7%

As indicated in the above table, the Company's commercial property operations have grown principally as a result of the addition of new properties over the past three years. The operating results of the consistent group of properties over the past three years has been improving, with net operating income increasing principally due to improved realized rental rates and declining operating expenses.

As discussed above, effective March 31, 1998, the Company will no longer consolidate PSBP and the Operating Partnership. This will have the effect of reducing commercial property revenue and cost of operations for those properties owned by PSBP and the Operating Partnership.



Equity in earnings of real estate entities: As of December 31, 1997, the Company had ownership interests in 29 affiliated limited partnerships and two affiliated REITs which comprise the Unconsolidated Entities. The Company's ownership interest in these entities is less than 50%. Due to the Company's limited ownership interest and control of these entities, the Company does not consolidate the accounts of these entities for financial reporting purposes.

Equity in earnings of real estate entities represents the Company's pro rata share of earnings of the Unconsolidated Entities using the equity method. Similar to the Company, the Unconsolidated Entities generate substantially all of their income from their ownership of self-storage facilities which are managed by the Company. In the aggregate, the Unconsolidated Entities own a total of 181 real estate facilities, 179 of which are self-storage facilities. The following table summarizes the components of the Company's equity in earnings of real estate entities:

(Amounts in thousands)	Year Ended December 31,			Year Ended December 31,		
	1997	1996	Dollar Change	1996	1995	Dollar Change
Self-storage operations ⁽¹⁾	\$ 31,026	\$ 41,722	\$(10,696)	\$ 41,722	\$ 6,573	\$ 35,149
Commercial property operations	1,428	2,667	(1,239)	2,667	269	2,398
Depreciation:						
Self-storage facilities	(10,935)	(15,709)	4,774	(15,709)	(1,909)	(13,800)
Commercial properties	(539)	(1,741)	1,202	(1,741)	(136)	(1,605)
Other ⁽²⁾	(3,411)	(4,818)	1,407	(4,818)	(1,034)	(3,784)
Total equity in earnings of real estate entities	\$ 17,569	\$ 22,121	\$ (4,552)	\$ 22,121	\$ 3,763	\$ 18,358

1. The fiscal 1997 amount includes the Company's share of operations from the joint venture partnership performing development activities of \$288,000.

2. Principally the Company's pro rata share of general and administrative expense and interest expense.

The decrease in 1997 earnings compared to 1996 is principally the result of certain business combinations occurring in 1996 and 1997 whereby the Company's existing ownership interest in certain entities were converted into wholly-owned real estate facilities (See Note 3 to the consolidated financial statements).

The increase in earnings in 1996 compared to 1995 is due to (i) the 1996 earnings reflecting a full year's operations for those interests acquired in the PSMI Merger as opposed to just one and one-half months in 1995, (ii) the Company's acquisition of additional interests during 1996 in the Unconsolidated Entities which resulted in increased earnings from these entities (See Note 5 to the consolidated financial statements) offset by (iii) certain business combinations occurring in 1996 whereby the Company's existing ownership interest in certain entities were converted into wholly-owned real estate facilities (See Note 3 to the consolidated financial statements).

The following table summarizes the combined operating data for fiscal 1997 (historical) with respect to those Unconsolidated Entities in which the Company had an ownership interest as of December 31, 1997:

(In thousands)	
Rental income	\$94,652
Total revenues	\$96,650
Cost of operations	\$33,077
Depreciation	\$12,805
Net income	\$40,775



Portable Self-Storage Operations

In August 1996, PSPUD, a subsidiary of the Company, made its initial entry into the portable self-storage business through its acquisition of a single facility operator located in Irvine, California. In the latter part of the fourth quarter of 1996, PSPUD opened 3 facilities in the Los Angeles market. During 1997, PSPUD opened a total of 45 facilities (9 facilities opened during the first quarter of 1997, 21 during the second quarter, 9 during the third quarter, and 6 during the fourth quarter of fiscal 1997).

Due to the start-up nature of the business, PSPUD incurred operating losses totaling approximately \$31.7 million and \$826,000 for the years ended December 31, 1997 and 1996, respectively, summarized as follows.

Portable Self-Storage:

(Dollar amounts in thousands)	Year Ended December 31,		Dollar Change
	1997	1996	
Rental and other income	\$ 7,893	\$ 421	\$ 7,472
Cost of operations:			
Direct operating costs	20,645	1,022	19,623
Marketing and advertising	10,441	19	10,422
Depreciation	1,394	32	1,362
General and administrative	7,078	174	6,904
	39,558	1,247	38,311
Operating losses	\$(31,665)	\$ (826)	\$(30,839)

PSPUD's facilities had a total of 36,000 occupied containers at December 31, 1997. Occupancy levels at the facilities varies significantly depending on opening date, size of the facility and rental activity. Of the 49 facilities opened as of December 31, 1997, 32 facilities had been opened in excess of seven months. The capacity of these 32 facilities ranges from 1,600 to 3,500 containers (averaging 2,140), and as of December 31, 1997 these facilities had occupancy levels ranging from 17% to 97% (averaging 43%). As with mini-warehouses, PSPUD believes that the portable self-storage business experiences some seasonal fluctuations in occupancy levels with occupancies generally higher in the summer months than the winter months.

During 1997, PSPUD experimented with monthly container rental rates and transportation fees charged to customers. At December 31, 1997, monthly rental rates for the 32 facilities ranged from \$45 to \$69 per container per month. Transportation fees charged to customers ranged from \$19 to \$49 for each of the move-in and move-out process. However, during 1997, PSPUD waived the move-in fee to customers.

PSPUD believes that marketing and advertising activities positively impact move-in activity. Commencing in the third quarter of 1997, PSPUD began to advertise the portable self-storage product on television in selected markets. Customers are directed to call the national reservation system where representatives discuss the customer's storage needs and are able to schedule delivery of containers to customers' locations. During 1997, approximately \$9.2 million and \$1.2 million was incurred in television and yellow pages advertising, respectively. Marketing and advertising activities have not been consistently implemented in all markets. PSPUD believes there may be markets in which its business will not be successful despite consistent marketing and advertising and is evaluating the advisability of continuing to operate in certain markets.

Currently all of the PSPUD facilities are operated in buildings which are leased from third parties. A typical facility generally has 6 personnel (manager and truck drivers), 2 to 4 trucks, and a corresponding number of forklifts. Substantially all the equipment is leased. Direct operating costs principally include payroll, facility and equipment (truck and forklift) lease expense.

During 1997, PSPUD incurred significant general and administrative costs related to recruiting and training personnel, equipment, computer software and professional fees in organizing this business. PSPUD will continue to expend funds during 1998 in connection with these activities. However, the amounts are expected to be less than in 1997.



During 1998, PSPUD has opened an additional 5 facilities in markets where PSPUD facilities are currently operating. The number of new store openings in 1998 is not determinable, however, future openings will predominantly be in existing markets in which PSPUD currently operates. By opening in existing markets, PSPUD will seek to gain benefits from economies of scale. PSPUD is also developing 10 facilities and has identified 5 additional sites for development. All of these development projects are located in existing markets with expected opening dates commencing during the second half of 1998.

Until the PSPUD facilities are operating profitably, PSPUD's operations are expected to continue to adversely impact the Company's earnings. PSPUD believes that its business is likely to be more successful in certain markets than in others. There can be no assurances as to the level of PSPUD's expansion, level of gross rentals, level of move-outs or profitability.

Property Management Operations

In connection with the PSMI Merger, the Company acquired property management contracts, exclusive of facilities owned by the Company, for self-storage facilities and, through a subsidiary, the management contracts for commercial properties. These facilities constitute all of the United States self-storage facilities and commercial properties doing business under the "Public Storage" name and all those in which the Company has an interest. At December 31, 1997, the Company managed 1,107 self-storage facilities (1,073 owned by affiliates of the Company and 34 owned by third parties) and the Operating Partnership managed 63 commercial properties, all of which are owned by the Company or affiliates of the Company.

The property management contracts generally provide for compensation equal to 6%, in the case of the self-storage facilities, and 5%, in the case of the commercial properties, of gross revenues of the facilities managed. Under the supervision of the property owners, the Company coordinates rental policies, rent collections, marketing activities, the purchase of equipment and supplies, maintenance activity, and the selection and engagement of vendors, suppliers and independent contractors. In addition, the Company assists and advises the property owners in establishing policies for the hire, discharge and supervision of employees for the operation of these facilities, including resident managers, assistant managers, relief managers and billing and maintenance personnel.

Property Management Operations:

(Amounts in thousands)	Year Ended December 31,			Year Ended December 31,		
	1997	1996	Dollar Change	1996	1995	Dollar Change
Facility management fees:						
Self-storage	\$ 9,706	\$13,474	\$(3,768)	\$13,474	\$1,976	\$11,498
Commercial properties	435	954	(519)	954	168	786
	10,141	14,428	(4,287)	14,428	2,144	12,284
Cost of operations:						
Self-storage	1,449	1,820	(371)	1,820	264	1,556
Commercial properties	344	755	(411)	755	88	667
	1,793	2,575	(782)	2,575	352	2,223
Net operating income:						
Self-storage	8,257	11,654	(3,397)	11,654	1,712	9,942
Commercial properties	91	199	(108)	199	80	119
	\$ 8,348	\$11,853	\$(3,505)	\$11,853	\$1,792	\$10,061

Because the Company has significant ownership interests in all but 34 of the facilities it manages, the revenues generated from its property management operations are generally predictable and are dependent upon the future growth of rental income for those facilities the Company manages. However, because the Company has acquired in the past, and may continue to seek to acquire in the future, real estate facilities owned by the Unconsolidated Entities, the Company's facility management income should decrease in 1998 compared to 1997. The acquisitions of such facilities will reduce management fee income.

Effective March 31, 1998, the Company will no longer consolidate PSBP and the Operating Partnership, the commercial properties manager. This will have the effect of eliminating commercial properties management fee income and cost of operations.



Other Income and Expense Items

Interest and other income: In an effort to attract a wider variety of customers, to further differentiate the Company from its competition and to generate new sources of revenues, additional businesses are being developed through the Company's subsidiaries that complement the Company's self-storage business. These products include the sale of locks, boxes and packing supplies and the rental of trucks and other moving equipment through the implementation of a retail expansion program and truck rental program. The net results of these businesses are presented along with interest and other income, as "interest and other income." The components of interest and other income are detailed as follows:

(In thousands)	Year Ended December 31,			Year Ended December 31,		
	1997	1996	Dollar Change	1996	1995	Dollar Change
Sales of packaging material and truck rental income:						
Revenues	\$5,272	\$3,083	\$2,189	\$3,083	\$ 112	\$2,971
Costs of operation	4,134	2,171	1,963	2,171	100	2,071
Net operating income	1,138	912	226	912	12	900
Interest and other income	7,988	7,064	924	7,064	4,497	2,567
Total interest and other income	\$9,126	\$7,976	\$1,150	\$7,976	\$4,509	\$3,467

The strategic objective of the retail expansion program is to create a "Retail Store" that will (i) rent spaces for the attached self-storage facility, (ii) rent spaces for the other Public Storage facilities in adjacent neighborhoods, (iii) sell locks, boxes and packing materials to the general public, including tenants and (iv) rent trucks and other moving equipment, all in an environment that is more retail oriented. Retail stores will be retrofitted to existing self-storage facility rental offices or "built-in" as part of the development of new self-storage facilities, both in high traffic, high visibility locations.

Interest and other income is primarily attributable to interest income on cash balances and interest income from mortgage notes receivable. Interest income from mortgage notes receivable was \$2,938,000, \$2,710,000 and \$1,974,000 in 1997, 1996 and 1995, respectively. The Company canceled mortgage notes receivable of approximately \$700,000 in 1996 and \$16,435,000 in 1995 in connection with the acquisition of real estate facilities securing such notes. The Company also acquired notes receivable of \$6,667,000 in the PSMI Merger in 1995 and an additional \$12,355,000 and \$3,709,000 in 1995 and 1996, respectively, from affiliated parties. The other increases in interest income are primarily attributable to fluctuations in the level of invested cash balances which are caused by the timing of investing equity offering proceeds in real estate assets.

Depreciation and amortization: Depreciation and amortization expense was \$91,356,000 in 1997, \$64,967,000 in 1996 and \$40,760,000 in 1995. These increases are principally due to the acquisition of additional real estate facilities in each period; the increase from 1995 to 1996 also includes the effect of amortization of intangible assets acquired in connection with the PSMI Merger. Depreciation expense with respect to the real estate facilities was \$82,047,000 in 1997, \$55,689,000 in 1996 and \$39,376,000 in 1995; the increases are due to the acquisition of additional real estate facilities in 1995 through 1997. Amortization expense with respect to intangible assets acquired in the PSMI Merger totaled \$9,309,000 in 1997, \$9,309,000 in 1996 and \$1,164,000 in 1995 (the 1995 amount representing a pro rated amount from November 16, 1995 through the end of the year).

General and administrative expense: General and administrative expense was \$6,384,000 in 1997, \$5,524,000 in 1996 and \$3,982,000 in 1995. The Company has experienced and expects to continue to experience increased general and administrative costs due to the following: (i) the growth in the size of the Company, (ii) the Company's property acquisition activities have continued to expand, resulting in certain additional costs incurred in connection with the acquisition of additional real estate facilities, and (iii) pursuant to the PSMI Merger, the Company became self-advised, resulting in the Company internalizing management functions which previously were provided by the Company's investment adviser. However, offsetting the increases in general and administrative expenses has been the elimination of advisory fee expense. General and administrative costs for each year principally consist of state income taxes (for states in which the Company is a non-resident), investor relation expenses, and certain overhead associated with the acquisition and development of real estate facilities.



Interest expense: Interest expense was \$6,792,000 in 1997, \$8,482,000 in 1996 and \$8,508,000 in 1995. Reflecting the Company's reluctance to finance its growth with debt, debt and related interest expense remains relatively low compared to the Company's overall asset base. The Company capitalized interest expense of \$2,428,000 in 1997, \$1,861,000 in 1996 and \$307,000 in 1995 in connection with the Company's development activities. Interest expense before the capitalization of interest was \$9,220,000 in 1997, \$10,343,000 in 1996 and \$8,815,000 in 1995. The decrease in interest expense in 1997 compared to 1996, is principally due to the retirement of debt in 1997 of approximately \$11.9 million. The increase in interest expense in 1996 compared to 1995, is principally due to the assumption of a \$65.5 million, 7.08% unsecured senior note in connection with the PSMI Merger on November 16, 1995.

Environmental costs: The Company's policy is to accrue environmental assessments and/or remediation cost when it is probable that such efforts will be required and the related costs can reasonably be estimated. The majority of the Company's real estate facilities were acquired prior to the time when it was customary to conduct environmental assessments. During 1995, the Company and the Consolidated Entities conducted independent environmental investigations of their real estate facilities. As a result of these investigations, the Company recorded an amount which, in management's best estimate, will be sufficient to satisfy anticipated costs of known remediation requirements. At December 31, 1995, the Company accrued \$2,741,000 for estimated environmental remediation costs. Although there can be no assurance, the Company is not aware of any environmental contamination of any of its facilities which individually or in the aggregate would be material to the Company's overall business, financial condition, or results of operations. The Company believes that amounts accrued in 1995 are sufficient to satisfy anticipated costs.

Advisory fees: Advisory fees were \$6,437,000 in 1995. The advisory fee, which was based on a contractual computation, increased as a result of increased adjusted net income (as defined) per common share combined with the issuance of additional preferred and common stock during each of the periods. Advisory fees for fiscal 1995 represent such amounts from the beginning of the year through November 16, 1995, when the Company became self-advised pursuant to the PSMI Merger. As a result of becoming self-advised, the Company no longer incurs advisory fees.

Minority interest in income: Minority interest in income represents the income allocable to equity interests in Consolidated Entities which are not owned by the Company. Since 1990, the Company has acquired portions of these equity interests through its acquisition of limited and general partnership interests in the Consolidated Entities. These acquisitions have resulted in reductions to the "Minority interest in income" from what it would otherwise have been in the absence of such acquisitions, and accordingly, have increased the Company's share of the Consolidated Entities' income. However, offsetting the reduction in minority interest in 1997 caused by the acquisition of additional equity interests are the inclusion of additional partnerships in the Company's consolidated financial statements as well as improved property operations. During 1997, the Company acquired sufficient ownership interest and control in 12 partnerships and commenced including the accounts of these partnerships in the Company's consolidated financial statements which amounted to an increase in minority interest in income of approximately \$1,961,000 in 1997.

In determining income allocable to the minority interest for 1997, 1996 and 1995 consolidated depreciation and amortization expense of approximately \$9,245,000, \$11,490,000 and \$11,243,000, respectively, was allocated to the minority interest. The changes in depreciation allocated to the minority interest was principally the result of the acquisition of limited partnership units in the Consolidated Entities by the Company throughout fiscal 1995, 1996 and 1997 offset by an increase resulting from the above mentioned consolidation of partnerships.

Impact of Year 2000

The Company has completed an initial assessment of its computer systems. The majority of the computer programs were installed or upgraded over the past few years and are Year 2000 compliant. Some of the older computer programs utilized by the Company were written without regard for Year 2000 issues and could cause a system failure or miscalculations with possible disruption of operations. Each of these computer programs and systems has been evaluated to be upgraded or replaced as part of the Company's Year 2000 project.

The cost of the Year 2000 project will be allocated to all entities that use the Company computer systems. The cost of the Year 2000 project which is expected to be allocated to the Company is approximately \$2.8 million. The cost of new software will be capitalized and the cost of software maintenance will be expensed as incurred.



The project is expected to be completed by March 31, 1999 which is prior to any anticipated impact on operating systems. The Company believes that with modifications to existing software and, in some instances, the conversion to new software, the Year 2000 issue will not pose significant operational problems. However, if such modifications are not made, or are not completed timely, the Year 2000 issue could have a material impact on the operations of the Company.

The costs of the project and the date on which the Company believes it will complete the Year 2000 modifications are based on management's best estimates, which were derived utilizing numerous assumptions of future events. There can be no guarantee that these estimates will be achieved and actual results could differ materially from those anticipated.

Supplemental Property Data and Trends

There are approximately 69 ownership entities owning in aggregate 1,073 self-storage facilities, including the facilities which the Company owns and/or operates. At December 31, 1997, 179 of these facilities were owned by Unconsolidated Entities, entities in which the Company has an ownership interest and uses the equity method for financial statement presentation. The remaining 894 facilities are owned by the Company and Consolidated Entities, many of which were acquired through business combinations with affiliates during 1997, 1996 and 1995.

In order to evaluate how the Company's overall portfolio has performed, management analyzes the operating performance of a consistent group of self-storage facilities representing 951 (55.8 million net rentable square feet) of the 1,073 self-storage facilities (herein referred to as "Same Store" self-storage facilities). The 951 facilities represents a consistent pool of properties which have been operated under the "Public Storage" name, at a stabilized level, by the Company since January 1, 1993. The Same Store group of properties includes 780 consolidated facilities (many of which were not included in the Company's consolidated financial statements throughout each of the three years presented) and 171 facilities owned by Unconsolidated Entities. The following table summarizes the pre-depreciation historical operating results of the Same Store self-storage facilities:

Same Store Self-Storage Facilities:

(Historical property operations)

(Dollar amounts in thousands, except rent per square foot)	Year Ended December 31,			Year Ended December 31,		
	1997	1996	Percentage Change	1996	1995	Percentage Change
Rental income	\$475,171	\$445,586	6.6%	\$445,586	\$422,933	5.4%
Cost of operations ⁽¹⁾	167,650	158,212	6.0%	158,212	149,660	5.7%
Net operating income	\$307,521	\$287,374	7.0%	\$287,374	\$273,273	5.2%
Gross profit margin ⁽³⁾	64.7%	64.5%	0.2%	64.5%	64.6%	(0.1)%
Weighted avg. occupancy	91.8%	91.2%	0.6%	91.2%	90.1%	1.1%
Weighted avg. realized annual rent per sq. ft. ⁽²⁾	\$9.24	\$8.76	5.5%	\$8.76	\$8.40	4.3%
Weighted avg. scheduled annual rent per sq. ft. ⁽²⁾	\$9.84	\$9.00	9.3%	\$9.00	\$8.16	10.3%

1. Assumes payment of property management fees on all facilities, including those facilities owned by the Company for which effective November 16, 1995 no fee is paid. Cost of operations consists of the following:

	1997	1996	1995
Payroll expense	\$ 44,233	\$ 43,490	\$ 42,545
Property taxes	44,476	40,799	38,325
Property management fees	28,490	26,139	25,391
Advertising	4,859	3,851	3,502
Telephone center costs	4,506	1,956	—
Other ⁽⁴⁾	41,086	41,977	39,897
	\$167,650	\$158,212	\$149,660

2. Realized rent per square foot as presented throughout this report represents the actual revenue earned per occupied square foot. Management believes this is a more relevant measure than the scheduled rental rates, since scheduled rates can be discounted through the use of promotions.

3. Gross profit margin is computed by dividing property net operating income (before depreciation expense) by rental revenues. Cost of operations includes a 6% management fee. The gross profit margin excluding the facility management fee was 70.7%, 70.5% and 70.6% in 1997, 1996 and 1995, respectively. On November 16, 1995, the Company acquired its facility manager and no longer incurs such fees on the properties it owns.

4. Other expenses principally include utilities, repairs and maintenance, and other items such as office expenses.



As indicated above, in early 1996, the Company implemented a national telephone reservation system designed to provide added customer service for all the self-storage facilities under management by the Company. The Company believes that the improved operating results, as indicated in the above table, in large part are due to the success of the national telephone reservation system. However, the national telephone reservation system was not fully operational for most of the self-storage facilities until the latter part of the fourth quarter of 1996.

Rental income for the Same Store facilities included promotional discounts totaling \$16,708,000 in 1997 compared to \$6,000,000 in 1996 and \$729,000 in 1995, respectively. The significant increase in 1997 was principally due to experimentation with pricing and promotional discounts designed to increase rental activity.

The self-storage facilities experience minor seasonal fluctuations in occupancy levels with occupancies generally higher in the summer months than in the winter months. The Company believes that these fluctuations result in part from increased moving activities during the summer.

Same-Store Operating Trends by Region

	Northern California		Southern California		Texas		Florida		Illinois		Other states		Total	
	Amount	% change from prior year	Amount	% change from prior year	Amount	% change from prior year	Amount	% change from prior year	Amount	% change from prior year	Amount	% change from prior year	Amount	% change from prior year
Rental Revenues:														
1997	\$71,406	9.5%	\$85,944	8.1%	\$41,435	4.4%	\$29,248	4.8%	\$34,404	10.6%	\$212,734	5.3%	\$475,171	6.6%
1996	65,222	8.6%	79,524	4.9%	39,704	1.3%	27,908	3.1%	31,123	9.0%	202,105	5.1%	445,586	5.4%
1995	60,053	5.8%	75,826	3.6%	39,191	2.7%	27,066	3.1%	28,552	7.6%	192,245	5.4%	422,933	4.9%
Cost of operations														
1997	\$20,239	9.7%	\$25,862	5.2%	\$17,239	4.6%	\$11,638	8.0%	\$16,105	8.2%	\$ 76,567	3.5%	\$167,650	6.0%
1996	18,457	3.4%	24,580	5.7%	16,482	5.8%	10,772	3.5%	14,887	5.5%	73,034	6.7%	158,212	5.7%
1995	17,856	3.4%	23,250	(1.6)%	15,574	1.5%	10,412	1.1%	14,115	16.9%	68,453	3.5%	149,660	3.4%
Net operating income:														
1997	\$51,167	9.4%	\$60,082	9.4%	\$24,196	4.2%	\$17,610	2.8%	\$18,299	12.7%	\$136,167	5.5%	\$307,521	7.0%
1996	46,765	10.8%	54,944	4.5%	23,222	(1.7)%	17,136	2.9%	16,236	12.5%	129,071	4.3%	287,374	5.2%
1995	42,197	6.8%	52,576	6.1%	23,617	3.5%	16,654	4.5%	14,437	(0.1)%	123,792	6.5%	273,273	5.7%
Weighted avg. occupancy														
1997	96.1%	1.6%	91.5%	4.2%	92.3%	2.7%	90.6%	1.9%	91.5%	(1.3)%	90.9%	(1.3)%	91.8%	0.6%
1996	94.5%	3.4%	87.3%	2.1%	89.6%	1.2%	88.7%	0.2%	92.8%	-	92.2%	0.5%	91.2%	1.1%
1995	91.1%	3.5%	85.2%	2.4%	88.4%	-	88.5%	(1.3)%	92.8%	2.0%	91.7%	0.3%	90.1%	1.0%
Weighted avg. annual realized rents per sq. ft.														
1997	\$11.04	8.2%	\$10.56	2.3%	\$6.96	1.8%	\$8.28	3.0%	\$9.84	10.8%	\$9.00	7.1%	\$9.24	5.5%
1996	10.20	4.9%	10.32	2.4%	6.84	-	8.04	3.1%	8.88	8.8%	8.40	4.5%	8.76	4.3%
1995	9.72	2.5%	10.08	1.2%	6.84	1.8%	7.80	4.8%	8.16	4.6%	8.04	4.7%	8.40	2.9%

Liquidity and Capital Resources

The Company believes that its internally generated net cash provided by operating activities will continue to be sufficient to enable it to meet its operating expenses, capital improvements, debt service requirements and distributions to shareholders for the foreseeable future. Net cash provided by operating activities (as determined in accordance with generally accepted accounting principles) reflects the cash generated from the Company's business before distributions to various equity holders, including the preferred shareholders, capital expenditures or mandatory principal payments on debt.



Operating as a real estate investment trust (“REIT”), the Company’s ability to retain cash flow for reinvestment is restricted. In order for the Company to maintain its favored REIT status, a substantial portion of its operating cash flow must be used to make distributions to its shareholders (see “REIT status” below). The following table summarizes the Company’s ability to pay the minority interests’ distributions, its dividends to the preferred shareholders and capital improvements to maintain the facilities through the use of cash provided by operating activities. The remaining cash flow generated is available to the Company to make both scheduled and optional principal payments on debt, pay distributions to common shareholders and for reinvestment.

(In thousands)	For the Year Ended December 31,		
	1997	1996	1995
Net income	\$178,649	\$153,549	\$ 70,386
Depreciation and amortization	91,356	64,967	40,760
Depreciation from Unconsolidated Entities	11,474	17,450	2,045
Minority interest in income	11,684	9,363	7,137
Environmental accrual	—	—	3,251
Net cash provided by operating activities	293,163	245,329	123,579
Distributions from operations to minority interests	(20,929)	(20,853)	(18,380)
Cash from operations allocable to the Company’s shareholders	272,234	224,476	105,199
Less: preferred stock dividends	(88,393)	(68,599)	(31,124)
Add: non-recurring payment of dividends with respect to the Series CC convertible stock	13,412	—	—
Cash from operations available to common shareholders	197,253	155,877	74,075
Capital improvements to maintain facilities:			
Self-storage facilities	(30,834)	(15,957)	(8,509)
Commercial properties	(4,283)	(4,409)	(2,852)
Add back: minority interest share of capital improvements to maintain facilities	2,513	3,159	3,219
Funds available for principal payments on debt, common dividends and reinvestment	164,649	138,670	65,933
Cash distributions to common shareholders	(86,181)	(67,709)	(38,586)
Funds available for principal payments on debt and reinvestment	\$ 78,468	\$ 70,961	\$ 27,347

The fiscal 1997 funds available for principal payments on debt and reinvestment includes the start-up operating losses related to PSPUD’s new portable self-storage business of \$31.7 million. Management views such losses as part of the reinvestment of the Company’s internally generated cash flows in PSPUD.

Distributions requirements: The Company’s conservative distribution policy has been the principal reason for the Company’s ability to retain significant operating cash flows which have been used to make additional investments and debt reductions. During 1995, 1996 and 1997, the Company distributed to common shareholders approximately 52%, 43% and 44% of its cash available from operations allocable to common shareholders, respectively.

During 1997, the Company paid dividends totaling \$68,534,000 to the holders of the Company’s Senior Preferred Stock, \$4,531,000 to the holders of the Convertible Preferred Stock, \$15,328,000 to the holders of the Series CC Convertible Preferred Stock (which converted to common stock during the second quarter of 1997) and \$86,181,000 to the holders of Common Stock. Dividends with respect to the Senior Preferred Stock include pro-rated amounts for securities issued during 1997. The Company estimates the distribution requirements for fiscal 1998 with respect to Senior Preferred Stock and the Convertible Preferred Stock to be approximately \$80.7 million. Distributions with respect to the common stock will be determined based upon the Company’s REIT distribution requirements after taking into consideration distributions to the Company’s preferred shareholders.

Capital improvement requirements: During 1998, the Company has budgeted approximately \$27.4 million for capital improvements (\$22.9 million for its self-storage facilities and \$4.5 million for its commercial properties). The minority interests’ share of the budgeted capital improvements is approximately \$3.8 million.

During 1995, the Company commenced a program to enhance its visual icon and modernize the appearance of its self-storage facilities, including modernization of signs, paint color schemes, and rental offices. Included in the 1998 capital improvement budget is approximately \$3.2 million with respect to these expenditures.

The significant increase in capital improvements in 1997 for the self-storage facilities (as reflected in the table above) is due to the acquisition of new facilities in 1997.



Debt service requirements: The Company does not believe it has any significant refinancing risks with respect to its mortgage debt, all of which is fixed rate. At December 31, 1997, the Company had total outstanding notes payable of approximately \$96.6 million and \$7 million outstanding on the credit facility. See Note 7 to the consolidated financial statements for approximate principal maturities of such borrowings.

The Company uses its \$150 million bank credit facility (all of which was unused as of March 27, 1998) primarily to fund acquisitions and provide financial flexibility and liquidity. The credit facility currently bears interest at LIBOR plus 0.40% based on the Company's current financial ratios.

Growth strategies: During 1998, the Company intends to continue to expand its asset and capital base principally through the (i) acquisition of real estate assets and interests in real estate assets from both unaffiliated and affiliated parties through direct purchases, mergers, tender offers or other transactions, (ii) development of additional self-storage facilities and (iii) the expected expansion in the operations of PSPUD's portable self-storage business.

Mergers with affiliates: As indicated above, in March 1998, the Company's private REIT merged with and into Properties 11, a publicly traded real estate investment trust affiliated with the Company. In connection with the merger, the Company exchanged 11 wholly owned commercial properties with the surviving corporation for 13 self-storage facilities. At December 31, 1997, the Company and the Consolidated Entities owned approximately a 68% interest in the private REIT and the Operating Partnership on a combined basis and a 37% interest in Properties 11. Upon completion of the merger, the Company and the Consolidated Entities own approximately 58% of the surviving corporation and the Operating Partnership on a combined basis.

In February 1998, Public Storage Properties XX, Inc. ("Properties 20") agreed, subject to certain conditions, to merge with and into the Company. Properties 20 is an affiliated publicly traded equity REIT. The merger is conditioned on approval by the shareholders of Properties 20. At December 31, 1997, the Company owned approximately 24% of Properties 20. The Company expects that, if approved by the shareholders, the merger would be completed in the second quarter of 1998. Properties 20 is the last remaining affiliated REIT involved in the ownership of self-storage facilities.

In addition to 533 wholly owned self-storage facilities, the Company operates, on behalf of approximately 64 ownership entities, 540 self-storage facilities under the "Public Storage" name in which the Company has a partial equity interest. From time to time, some of these self-storage facilities or interests in them are available for purchase, providing the Company with a source of additional acquisition opportunities.

Development of self-storage facilities: Commencing in 1995, the Company began to construct self-storage facilities. Since 1995, the Company has opened a total of seven facilities, one in 1995, four in 1996, and two in 1997. The Company is evaluating the feasibility of developing additional self-storage facilities in selected markets in which there are few, if any, facilities to acquire at attractive prices and where the scarcity of other undeveloped parcels of land or other impediments to development make it difficult to construct additional competing facilities.

In April 1997, the Company formed a joint venture partnership with a state pension fund to participate in the development of approximately \$220 million of self-storage facilities. At December 31, 1997, the joint venture partnership had completed construction of seven self-storage facilities (approximately 412,000 net rentable square feet) with a total cost of approximately \$40.8 million, and had 17 facilities under construction (approximately 1,169,000 net rentable square feet) with an aggregate cost incurred to date of approximately \$48.9 million and total additional estimated cost to complete of \$29.3 million. The partnership is funded solely with equity capital consisting of 30% from the Company and 70% from the state pension fund.

Portable self-storage business: As indicated above, in 1996 the Company organized PSPUD as a separate corporation to operate a portable self-storage business that rents storage containers to customers for storage in central warehouses. As of December 31, 1997, PSPUD operated a total of 49 facilities in 24 greater metropolitan areas in 16 states. In January and February 1998, PSPUD opened five additional facilities. PSPUD has also identified an additional 15 sites in existing markets for development of PSPUD facilities at an aggregate estimated cost of \$67.5 million.



Financing the Company's growth strategies: The Company expects to fund its growth strategies with cash on hand at December 31, 1997, internally generated retained cash flows and borrowings under its \$150 million credit facility. The Company intends to repay amounts borrowed under the credit facility from undistributed operating cash flow or, as market conditions permit and are determined to be advantageous, from the public or private placement of equity securities.

The Company believes that its size and financial flexibility enables it to access capital for growth when appropriate. The Company's financial profile is characterized by a low level of debt to total capitalization, increasing net income, increasing cash flow from operations, and a conservative dividend payout ratio with respect to the common stock. The Company's credit ratings on its Senior Preferred Stock by each of the three major credit agencies are Baa2 by Moody's and BBB+ by Standard and Poor's and Duff & Phelps.

The Company's portfolio of real estate facilities remains substantially unencumbered. At December 31, 1997, the Company had mortgage debt outstanding of \$43.3 million and had consolidated real estate facilities with a book value of \$2.7 billion. The Company has been reluctant to finance its acquisitions with debt and generally will only increase its mortgage borrowing through the assumption of pre-existing debt on acquired real estate facilities.

Over the past three years the Company has funded substantially all of its acquisitions with permanent capital (both common and preferred stock). The Company has elected to use preferred stock despite the fact that the dividend rates of its preferred stock exceeds current interest rates on conventional debt. The Company has chosen this method of financing for the following reasons: (i) the Company's perpetual preferred stock has no sinking fund requirement, or maturity date and does not require redemption, all of which eliminate any future refinancing risks, (ii) preferred stock allows the Company to leverage the common stock without the attendant interest rate or refinancing risks of debt, and (iii) like interest payments, dividends on the preferred stock can be applied to the Company's REIT distributions requirements, which have helped the Company to maintain a low common stock dividend payout ratio and retain cash flow.

Since January 1, 1998, the Company has issued an aggregate of approximately 6.4 million shares of common stock, raising net proceeds of approximately \$189 million. The Company intends to use the net proceeds from these offerings to make investments in real estate, primarily self-storage, including mortgage loans and interest in real estate partnerships, to satisfy cash elections in connection with mergers with affiliated REITs and to fund investments in PSPUD.

REIT status: The Company believes that it has operated, and intends to continue to operate, in such a manner as to qualify as a REIT under the Internal Revenue Code of 1986, but no assurance can be given that it will at all times so qualify. To the extent that the Company continues to qualify as a REIT, it will not be taxed, with certain limited exceptions, on the taxable income that is distributed to its shareholders, provided that at least 95% of its taxable income is so distributed prior to filing of the Company's tax return. The Company has satisfied the REIT distribution requirement since 1980.

Funds from operations: Total funds from operations or "FFO" increased to \$272,234,000 for the year ended December 31, 1997 compared to \$224,476,000 in 1996 and \$105,199,000 in 1995. FFO available to common shareholders (after deducting preferred stock dividends) increased to \$197,253,000 for the year ended December 31, 1997 compared to \$155,877,000 in 1996 and \$74,075,000 in 1995. FFO means net income (loss) (computed in accordance with generally accepted accounting principles) before (i) gain (loss) on early extinguishment of debt, (ii) minority interest in income and (iii) gain (loss) on disposition of real estate, adjusted as follows: (i) plus depreciation and amortization (including the Company's pro-rata share of depreciation and amortization of unconsolidated equity interests and amortization of assets acquired in the PSMI Merger, including property management agreements and goodwill), and (ii) less FFO attributable to minority interest.

FFO is a supplemental performance measure for equity REITs as defined by the National Association of Real Estate Investment Trusts, Inc. ("NAREIT"). The NAREIT definition does not specifically address the treatment of minority interest in the determination of FFO or the treatment of the amortization of property management agreements and goodwill. In the case of the Company, FFO represents amounts attributable to its shareholders after deducting amounts attributable to the minority interests and before deductions for the amortization of property management agreements and goodwill. FFO is presented because many industry analysts consider FFO to be one measure of the performance of the Company and it is used in establishing the terms of the Class B Common Stock. FFO does not take into consideration capital improvements, scheduled principal payments on debt, distributions and other obligations of the Company. Accordingly, FFO is not a substitute for the Company's cash flow or net income (as discussed above) as a measure of the Company's liquidity or operating performance.



Common Stock Distribution Policy and Stock Price

Public Storage, Inc. has paid continuous quarterly distributions to its shareholders since 1981, its first full year of operations. Distributions paid per share of common stock for 1997 amount to \$.88.

Holders of common stock are entitled to receive distributions when and if declared by the Company's Board of Directors out of any funds legally available for that purpose. The Company is required to distribute at least 95% of its net taxable ordinary income prior to the filing of the Company's tax return and 85%, subject to certain adjustments, during the calendar year, to maintain its REIT status for Federal income tax purposes. It is management's intention to pay distributions of not less than this required amount. For Federal tax purposes, distributions to shareholders are treated as ordinary income, capital gains, return of capital or a combination thereof, and for the past three years distributions to common shareholders were as follows:

Year Ended	Amount Paid	Ordinary Income	Capital Gain Amount	Non-taxable Return of Capital
1997	\$.88	\$.88	\$ —	\$ —
1996	.88	.88	—	—
1995	.88	.88	—	—

The common stock has been listed on the New York Stock Exchange since October 19, 1984 and on the Pacific Exchange since December 26, 1996. The ticker symbol is PSA.

The following table sets forth the high and low sales prices of the common stock on the New York Stock Exchange composite tapes for the applicable periods.

Year	Quarter	Range	
		High	Low
1996	1st	\$21.875	\$18.875
	2nd	21.500	19.375
	3rd	22.625	19.875
	4th	31.375	22.250
1997	1st	\$30.875	\$26.500
	2nd	29.250	25.875
	3rd	30.875	27.000
	4th	30.625	26.125

As of March 2, 1998, there were approximately 23,716 holders of record of the common stock. The Company had approximately 111,723,882 common shares outstanding as of February 28, 1998.



Corporate Data

Public Storage, Inc. <http://www.publicstorage.com>

Directors

B. Wayne Hughes (1980)
*Chairman of the Board and
Chief Executive Officer*

Harvey Lenkin (1991)
President

B. Wayne Hughes, Jr. (1998)
Vice President-Acquisitions

Robert J. Abernethy (1980)
*President, American Standard
Development Company and
Self-Storage Management Company*

Dann V. Angeloff (1980)
President, The Angeloff Company

William C. Baker (1991)
*Chairman and
Chief Executive Officer of
The Santa Anita Companies, Inc.*

Thomas J. Barrack, Jr. (1998)
*Chairman and Chief Executive
Officer of Colony Capital, Inc.*

Uri P. Harkham (1993)
*President and
Chief Executive Officer of the
Jonathan Martin Fashion Group*

*Date in parentheses indicates year director
was elected to the board.*

Public Storage Pickup & Delivery, Inc.

B. Wayne Hughes
President

Alan Grossman
Senior Vice President

Steve Donovan
Vice President-Western Operations

Randy Weissman
Vice President-Eastern Operations

Shareholders may obtain, without
charge, a copy of Form 10-K, as filed
with the Securities and Exchange
Commission by addressing a written
request to the Investor Services
Department at the Corporate Head-
quarters.

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Boston, Massachusetts
<http://www.EquiServe.com>

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Los Angeles, California

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