Public Storage, Inc.

1996 Annual Report

SELF STORAGE

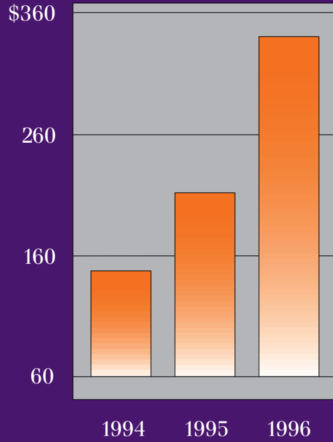
CONTAINER STORAGE

TRUCK RENTALS

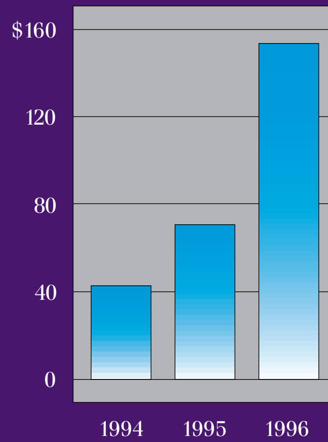
RETAIL STORES

25th Anniversary

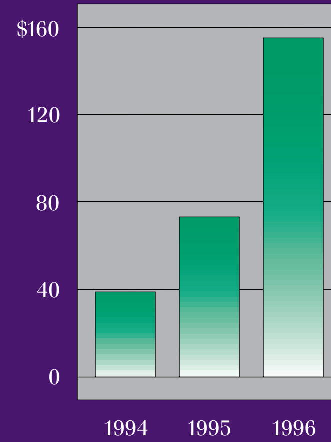
Total Revenues
In Millions



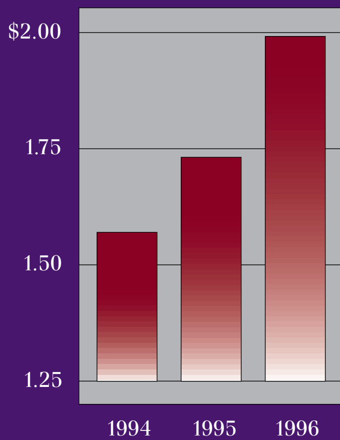
Net Income
In Millions



Funds From Operations Allocable To Common Shareholders
In Millions

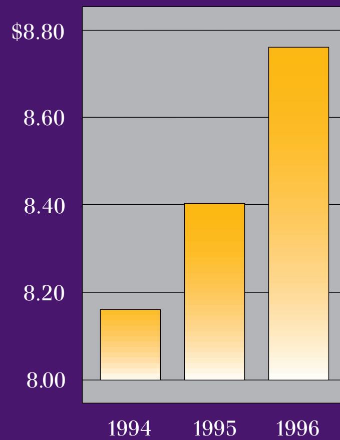


Funds From Operations Per Fully Diluted Common Share[(1)]



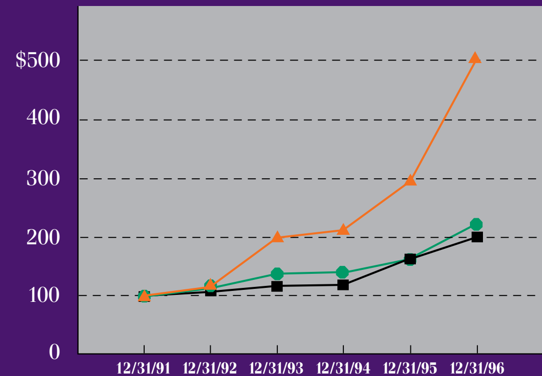
(1) Assumes the conversion of the Company's Convertible Preferred Stock into common stock.

Annual Realized Rent Per Square Foot
Same Store Facilities[(1)]



(1) "Same Store" refers to mini-warehouses in which the Company had an interest since January 1, 1993.

Stock Price Performance Graph[(1)]
Comparison of Cumulative Total Return
Public Storage, Inc., S&P 500 Index and NAREIT Equity Index
December 31, 1991 – December 31, 1996



	12/31/91	12/31/92	12/31/93	12/31/94	12/31/95	12/31/96
Public Storage, Inc.	$100.00	$117.80	$201.84	$215.57	$299.36	$507.39
S&P 500	$100.00	$107.62	$118.46	$120.03	$165.13	$203.05
NAREIT Equity	$100.00	$114.59	$137.11	$141.46	$163.06	$220.56

(1) The graph compares the yearly change in the Company's cumulative total shareholder return on its common stock for the five-year period ended December 31, 1996 to the cumulative total return of the Standard and Poor's 500 Stock Index ("S&P 500 Index") and the National Association of Real Estate Investment Trusts Equity Index ("NAREIT Equity Index") for the same period (total shareholder return equals price appreciation plus dividends). The stock price performance graph assumes that the value of the investment in the Company's common stock and each index was $100 on December 31, 1991 and that all dividends were reinvested. The stock price performance shown in the graph is not necessarily indicative of future price performance.

Selected Financial Highlights

(In thousands, except per share data) For the year ended December 31,	1996[(1)]	1995[(1)]	1994	1993	1992
Revenues:					
Rental income	$ 294,005	$ 202,134	$ 141,845	$ 109,203	$ 95,886
Equity in earnings of real estate entities	22,121	3,763	764	563	–
Facility management fees	14,428	2,144	–	–	–
Ancillary business income	3,504	112	–	–	–
Interest and other income	7,064	4,497	4,587	4,914	1,562
	341,122	212,650	147,196	114,680	97,448
Expenses:					
Cost of operations	93,244	72,247	52,816	42,116	38,348
Cost of facility management	2,575	352	–	–	–
Cost of operations – ancillary business	3,418	100	–	–	–
Depreciation and amortization	64,967	40,760	28,274	24,998	22,405
General and administrative	5,524	3,982	2,631	2,541	2,629
Interest expense	8,482	8,508	6,893	6,079	9,834
Environmental cost	–	2,741	–	–	–
Advisory fee	–	6,437	4,983	3,619	2,612
	178,210	135,127	95,597	79,353	75,828
Income before minority interest and gain on disposition of real estate	162,912	77,523	51,599	35,327	21,620
Minority interest in income	(9,363)	(7,137)	(9,481)	(7,291)	(6,895)
Income before gain on disposition of real estate	153,549	70,386	42,118	28,036	14,725
Gain on disposition of real estate, net	–	–	–	–	398
Net income	$ 153,549	$ 70,386	$ 42,118	$ 28,036	$ 15,123
Per Common Share:					
Income before gain on disposition of real estate	$1.10	$0.95	$1.05	$0.98	$0.88
Gain on disposition of real estate	–	–	–	–	0.02
Net income	$1.10	$0.95	$1.05	$0.98	$0.90
Distributions per common share	$0.88	$0.88	$0.85	$0.84	$0.84
Weighted average common shares	77,358	41,171	24,077	17,558	15,981
Total assets	$2,572,152	$1,937,461	$ 820,309	$ 666,133	$537,724
Total debt	$ 108,443	$ 158,052	$ 77,235	$ 84,076	$ 69,478
Minority interest	$ 116,805	$ 112,373	$ 141,227	$ 193,712	$202,797
Shareholders' equity	$2,305,437	$1,634,503	$ 587,786	$ 376,066	$253,669
Other Data:					
Net cash provided by operating activities	$ 245,237	$ 123,466	$ 79,180	$ 59,477	$ 44,025
Net cash used in investing activities	$ (479,626)	$ (248,672)	$(169,590)	$(137,429)	$ (21,010)
Net cash provided by (used in) financing activities	$ 180,809	$ 185,491	$ 100,029	$ 80,100	$ (21,010)
Funds from operations[(2)]	$ 224,384	$ 105,086	$ 56,143	$ 35,830	$ 21,133

(1) During 1996 and 1995 the Company completed several significant business combinations and equity transactions. See Notes 3 and 11 to the Company's consolidated financial statements.

(2) 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

In Memoriam

Kenneth Q. Volk, Jr.
Co-founder and
Chairman Emeritus
August 14, 1918 – June 3, 1996

He had the rare vision and talent to nearly single-handedly create an entire industry. We will miss his quiet and dignified leadership.

For the last 25 years Public Storage, Inc. has successfully provided self-storage solutions to a wide-range of Americans. We have grown and adapted in response to the changing needs of our customers. The theme of this year's annual report is how we are adding value for both our shareholders and our customers. We are adding value for shareholders by:

- Diversifying our self-storage operations with complementary businesses
- Utilizing retained cash flow for property acquisition and development
- Increasing funds from operations and cash available for distributions
- Leveraging our competitive strengths

Our customers are the engine that propel our enterprise. We are adding value to the self-storage experience for our 540,000 tenants by:

- Augmenting and improving the interaction between Public Storage and our customers
- Offering competitive pricing structures
- Providing professionally managed, clean, quality self-storage space in metropolitan markets
- Enhancing our property operations through new marketing mechanisms, systems and controls, and property repackaging programs

This letter will explain how and why we now see Public Storage as an umbrella under which four closely related business lines fit, the mechanisms through which we are promoting our established and developing business segments, our distinct competitive attributes, and our future plans.

A Fully Integrated Company

Public Storage is a diversified, nationwide enterprise possessing a strong operating business coupled with strong and flexible financial resources. In tandem, these strengths result in an organization that generates rising funds from operations and reinvests a substantial portion of its cash flows generated from operations. We use our established core operating business, solid financial strength, size and national presence, and trade name to support distinct, yet interrelated, existing and emerging lines of business. Along with our established core business, these complementary activities of our subsidiaries are designed to generate consumer demand for portable self-storage space, truck rentals, and purchase of move-related merchandise. Public Storage Pickup & Delivery,SM Truck Rentals, and Retail Stores are a logical extension of our core activity – owning and operating self-storage properties in major metropolitan markets throughout the United States. We can, for example, respond to cross-marketing opportunities with our self-storage properties at the nucleus of our services. Our national call reservation center contributes to our ability to offer "one-stop-shop" convenience. Indeed, a goal of our national call reservation center is to provide customers with a single point of contact for all their storage-related needs. We look at it as smart business. For our customers, it is as easy as calling one of our properties or our national toll-free number.

Public Storage offers the benefits of professional management, diversification, current income, infinite life and liquidity. However, we believe Public Storage has moved beyond the traditional expectation of real estate investment trusts as being primarily passive real estate portfolios. Specifically, we operate like a traditional operating company *within* the structure of a real estate investment trust. Public Storage is self-administered and self-managed. We have expertise in real estate development, construction, acquisition, operations and leasing services. We are fully involved in our self-storage, portable self-storage, truck rentals, and retail stores businesses. We believe that our multiple business line infrastructure adds value to Public Storage for shareholders and our customers.

We use our retained operating cash as an internal source of capital for property acquisition, development and debt reduction. Approximately $71 million of funds from operations were retained in 1996 and we expect to retain approximately $100 million in 1997. We believe cash retention enhances Public Storage's value and anticipate continuing this long-term goal.

Realizing Benefits of The 1995 Merger

The major merger on November 16, 1995 consolidating Storage Equities, Inc. and Public Storage, Inc. helped position us for growth in 1996. It enhanced our competitive position and made Public Storage's structure more efficient. The merger produced a company of substantial size and diversification. Based on capitalized market value, we are now one of the largest real estate investment trusts in the United States. We own and operate more self-storage space than any of our competitors. As a direct result of the merger, the three major credit rating agencies

upgraded our credit rating, reducing our cost of new capital. The merger significantly reduced internal conflicts inherent in the separate advisor/property manager format. Institutional investor interest in our corporation has improved. We believe we experienced numerous positives from the merger throughout 1996 and expect this direction to be maintained in the future.

CAPITALIZING ON ESTABLISHED COMPETITIVE STRENGTHS

We believe that Public Storage possesses strengths which are difficult for our competitors to reproduce. These include:

- Strong operating business
- Financial strength
- Trade name
- Market share
- Geographic diversification
- Management

Strong operating business. Funds from operations (FFO) per common share is considered a key measure of the performance of Public Storage. FFO per common share advanced 14 percent, from $1.73 per share for the year ended December 31, 1995, to $1.98 per share for the year ended December 31, 1996. We are adding to shareholder value by practicing a conservative approach to distributions. Retaining a substantial portion of funds from operations (after funding Public Storage's distributions and capital improvements) enables us to acquire and develop properties and reduce debt using internal cash resources. In this regard, Public Storage differs significantly from its competitors, a difference we believe is a favorable factor in our long-term business plans. We distributed 44 percent of FFO per common share for 1996 and 52 percent for 1995. Through our relatively moderate payout ratio in 1996 we retained $71 million of free capital to purchase and develop properties.

Occupancy levels have historically represented one of the simplest but most efficient windows into the strength and success of our business. They show the balance between the forces of supply and demand and the effects of our promotional activities. For the year ended December 31, 1996, occupancy at the self-storage properties on a Same Store basis averaged 91.2 percent, compared to 90.1 percent one year earlier. Same Stores are the 951 mini-warehouses that Public Storage has had an interest in since January 1, 1993.

The amount of rent Public Storage collects bears an important connection to occupancy trends. To the extent feasible we try to generate rising or high occupancy levels and rising rental rates. Same Store average annual realized rent represents the actual revenue earned per occupied square foot and is a more relevant measure than posted rental rates. Same Store average annual realized rent was $8.76 per square foot for the year ended December 31, 1996, compared to $8.40 per square foot for the same period of 1995, an increase of 4.3 percent. Same Store revenues equaled $445.6 million for the year ended December 31, 1996, compared to $422.9 million for the same period one year earlier, an increase of 5.4 percent.

Financial strength. We have a strong balance sheet. Total assets, total debt, and total shareholders' equity are barometers of our balance sheet strength. As of December 31, 1996, Public Storage's assets totaled approximately $2.6 billion, a $635 million increase from approximately $1.9 billion one year earlier. Public Storage's debt-to-equity ratio was reduced from approximately 10 percent at December 31, 1995 to 5 percent at December 31, 1996. Low debt leverage in conjunction with our access to capital should position us to respond to investment opportunities in our industry. Shareholders' equity equaled $2.3 billion as of December 31, 1996, approximately 41 percent greater than the $1.6 billion reported one year earlier.

Public Storage's common stock achieved all-time highs during 1996. Public Storage responded to its strong financial position during 1996 by completing two separate preferred stock offerings, raising $260 million, and two common stock offerings, raising approximately $129 million. In March 1997, Public Storage completed a common stock offering that raised approximately $127 million. Since January 1, 1993, Public Storage has issued approximately $1.022 billion of equity capital, the proceeds of which were used to reduce debt and acquire interests in self-storage properties.

The industry's most enduring icon.

Stock Performance(1)

The value of the Company's common stock has increased, reflecting in part growth opportunities in the Company's business.

STOCK PRICE RANGE

	High	Low	Close
1996			
1st quarter	$21⅞	$18⅞	$20⅜
2nd quarter	21½	19⅜	20⅝
3rd quarter	22⅝	19⅞	22⅝
4th quarter	31⅜	22¼	31
1995			
1st quarter	$17⅛	$13½	$17
2nd quarter	17⅛	15¼	16⅜
3rd quarter	18¾	16⅜	18⅝
4th quarter	19¾	17⅜	19

(1) The common stock has been listed on the New York Stock Exchange since October 19, 1984. The ticker symbol is PSA.

Public Storage completed eight merger transactions with affiliates in 1996, acquiring 105 properties.

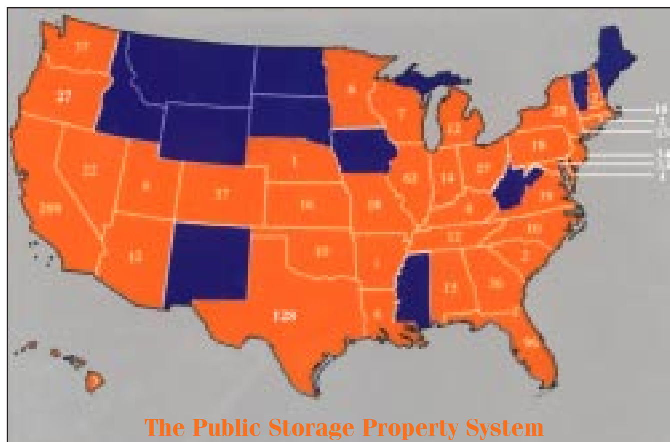
In December 1996, Public Storage and two affiliates, Public Storage Properties XIV, Inc., and Public Storage Properties XV, Inc., agreed, subject to certain conditions, to merge. Requirements for the mergers include the approval by the shareholders of each of the affiliates. If approved, the mergers are expected to be completed during the first half of 1997. These affiliates collectively own 31 self-storage properties and two business parks. Public Storage currently owns about one-third of the capital stock of each of these affiliates and manages the properties. We are continuing to evaluate transactions with other affiliates whose properties are managed by Public Storage.

From January 1, 1994 through December 31, 1996, Public Storage acquired, in cash tender offers, limited partnership interests in partnerships of which Public Storage is a general partner for an aggregate purchase price of approximately $86 million. These acquisitions are intended to reduce minority interest in the long-term and increase Public Storage's ownership interest in its current property portfolio.

Trade name. Public Storage's 1,064 self-storage or self-storage/business park combinations operate under the most recognized trade name in the self-storage industry. We believe that this enables us to provide continuity from one rental experience to the next, customers being able to expect the same level of quality and professionalism regardless of which Public Storage property they

choose to rent or which of our other storage-related services they choose to use.

Market share. By concentrating our properties in or near major metropolitan areas we can take advantage of market share and economies of scale. Indeed, clustering our properties around a common economic focal point allows for the cost effective distribution of marketing expenditures, economies of scale, and management supervision. These factors contribute to our properties' operating margins. Additionally, operating numerous properties in a market helps our national reservation center maximize its capacity to effectively shop space for customers, simplifying their search for the exact size, location, and price.



The Public Storage Property System

Geographic diversification. Our sizeable portfolio is geographically diversified, providing additional competitive advantages. No single self-storage property accounts for more than one percent of revenues. We also believe that we can generate more stable cash flows because a large, diversified portfolio can better absorb local economic downturns.

Management. Another strength of Public Storage is the substantial experience and expertise of our senior officers. They have significant operating and financial experience. They have been responsible for the acquisition of more than 350 self-storage properties, the development of more than 650 self-storage properties and the management of more than 1,000 self-storage properties over the last 25 years. We also benefit from our efficient property management team. They use systems and controls, performance standards, and operating procedures to effectively manage the day-to-day demands of our enterprise. The property management division is comprised of approximately 2,800 personnel. A continuing objective of our management system is to cultivate a customer base which is satisfied with our product and services.

DEVELOPING NEW COMPETITIVE STRENGTHS

We are developing new ways to market our self-storage properties, portable self-storage, truck rentals and retail stores, to enhance the visual appeal of our properties, to improve how customers locate a Public Storage property and how we manage our operations. These new activities encompass:

- National reservation center
- Directory advertising
- Visual repackaging
- Systems and controls
- The Internet

National reservation center. We designed the national reservation center to contribute to our competitive edge by continuously offering our customers new and better services and products. We inaugurated the center in December 1995. At December 31, 1996, 87 representatives were on staff using an integrated telephone and computer system to access current information about space availability and rates for the majority of Public Storage's properties. A customer calling a property, or Public Storage's national toll-free number (1-800-44-STORE), can be connected with the center. The center currently receives about 120,000 calls per month. We can market all of our business lines through the national reservation center. We believe that improving and expanding upon our ability to generate customer demand enables us to support favorable occupancy trends through the national reservation center. We believe that we alone offer a broad, technologically-advanced service such as this.

Directory advertising. We are expanding the number of markets in which directory advertising is used and the number of directories in which a Public Storage display ad appears. We are currently using Yellow Pages advertising in over 700 directories in 80 markets. We are utilizing larger-sized ads to identify all the properties in a given market, and where appropriate are using ads for our portable self-storage business in tandem with ads for traditional self-storage space. Directory advertising is the most important of the print media in promoting our services since about one-third of our customers locate a property through our directory ads. We have an internal Yellow Pages agency.

Visual repackaging. Many of our properties have now had their appearance improved to augment their competitiveness in an increasingly cluttered visual landscape. Modernizing the look of the old orange and black "Ps" logo and facility signage should also add to the customer-friendliness of our image and convey the cutting-edge nature of our approach to property management. Reaction to our new orange and plum logo and signage has been favorable. The program should also help promote consistency in appearance from property to property. We added to the value of our properties by investing about $6 million in 1996 with this program and expect to invest approximately that amount in 1997.

Systems and controls. Last year we began to update and expand the software used in our computerized property management system. The system, installed at each of our properties, transmits and receives data regarding unit availability, delinquencies, accounting and cash management. We enhanced the software package to allow us to track the sales activity of all the merchandise products and to monitor the effectiveness of our national reservation center.

The Internet. The number of hits our user-friendly home page receives is steadily growing. Customers can complete rental applications through our Internet site. We use our national reservation center to follow-up on rental applications received through the Internet. We expanded our investor service function on our home page, providing alternative methods for shareholders to communicate with us and with Public Storage's transfer agent. We are exploring additional ways to benefit from the Internet. Our Internet address is http://www.publicstorage.com. We welcome your suggestions or comments.

FUTURE OPPORTUNITIES

During 1996 Public Storage continued to grow. However, not everything is clear sailing in the mini-warehouse industry and there could be a squall or two on the horizon. Supply and demand factors fluctuate, variables which are intensified by new construction activities. Supply/demand disequilibrium could result in negative trends in mini-warehouse occupancy levels and rental rates in affected markets. Nevertheless, we are optimistic that our com-

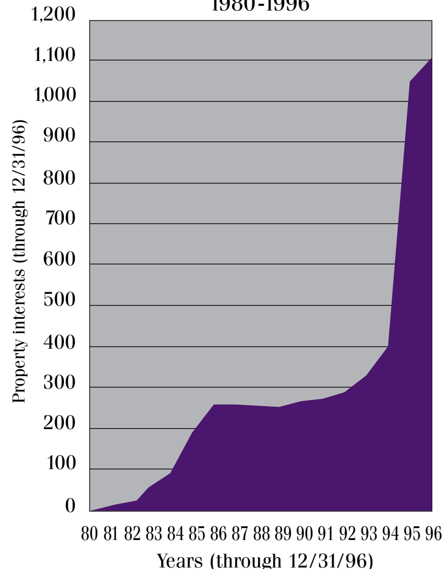
petitive advantages will continue to attenuate the effects of these pressures. Our strengths include the significant operating and financial experience of our executive officers and directors, Public Storage's strong operating business and financial strength, national investment scope, geographic diversification, economies of scale, and our trade name.

In February 1997 we reached an agreement in principle with a joint venture partner to participate in funding the development of approximately $220 million of mini-warehouses (including the properties currently under development by Public Storage). The joint venture partner would contribute about 70 percent of the venture's capital with the balance provided by Public Storage. After a period of time, Public Storage would have an option to acquire the other venture partner's interest. The construction of self-storage properties and the relatively long "fill-up" period to reach a stabilized occupancy level creates short-term earnings dilution. We expect that the development joint venture will alleviate this earnings dilution. There can be no assurance that a definitive agreement can be reached between Public Storage and the joint venture partner. Assuming an agreement is finalized, it is expected that the joint venture would be funded in April 1997.

As of December 31, 1996 we had five recently developed self-storage properties (costs of $23.5 million) open and in the fill-up stage. An additional 11 facilities were under construction (estimated costs of $56 million) with expected opening dates ranging from January 1997 through March 1998. Our investment strategy will continue to include developing mini-warehouses. Consequently, we have approved the development of an additional 17 facilities (estimated costs of $70.2 million) with construction and completion dates through mid-1998. We are currently evaluating the feasibility of developing additional mini-warehouses 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.

At the end of 1996 Public Storage and HFS Incorporated, the world's largest franchisor of residential real estate brokerage offices, entered into a three-year preferred vendor agreement to co-market rental storage space to franchisees and customers of HFS Incorporated's three real estate brands. The agreement provides certain pricing discounts on self-storage rental space for CENTURY 21,® Coldwell Banker,® and ERA® franchised brokerages and their customers. We should be able to use our national reservation center to offer these services to the clientele of some of the largest real estate brand names in the country.

Last year we opened, on an experimental basis, complete storage-related retail centers at self-storage locations in Atlanta, Georgia and Southern California. We plan to continue opening retail stores in selected markets. Currently, we have 13 retail stores in operation and 20 retail store conversions. If the previously discussed joint venture agreement is reached, all future development projects, including projects currently under construction and development, will be presented to the joint venture for approval and acceptance into their portfolio. Public Storage will then have the option to construct any project not approved by the joint venture. Almost all newly constructed Public Storage self-storage properties will feature a retail operation. The retail operations are performed through a subsidiary of the Company.



In 1996 we organized Public Storage Pickup & Delivery℠ (PSPUD) as a separate corporation to operate a portable self-storage business that rents storage containers to customers for storage in central warehouses and provides related transportation services. PSPUD currently operates a total of twelve facilities in six greater metropolitan areas in California and Texas. PSPUD anticipates opening four additional facilities in these areas and in three additional metropolitan areas by the end of the first quarter of 1997. PSPUD presently anticipates expanding its operations to a significant number of additional areas during the remainder of 1997 and in 1998, subject to continuing evaluation of the feasibility of this business and the satisfaction of regulatory requirements. There can be no assurance on the level of PSPUD's expansion or profitability.

Maintaining Industry Leadership

We entered 1996 with substantial momentum from the merger that was consummated on November 16, 1995. That merger increased our competitive position and provided for a more efficient organizational structure. As we progressed through 1996 we enhanced the economic value of our business at the property level. We did this primarily by completing financial transactions that improved our balance sheet, incorporating new information and operating technologies into our property management system, and expanding the complementary businesses that now constitute part of the Public Storage infrastructure.

In evaluating how effectively we are accommodating our customers' needs, we emphasize certain key elements: value, service, location, product, and marketing. To our 540,000 customers, adding value to their self-storage experience means maximizing the "what they receive" side of the equation while minimizing the "what they pay" side of the equation. We anticipate our shareholders will benefit from our long-term operating and investment strategies and our substantial strengths in 1997 and beyond, and we thank our shareholders for their continued support.

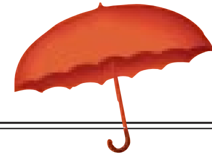
Sincerely,

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

Harvey Lenkin
President

March 31, 1997

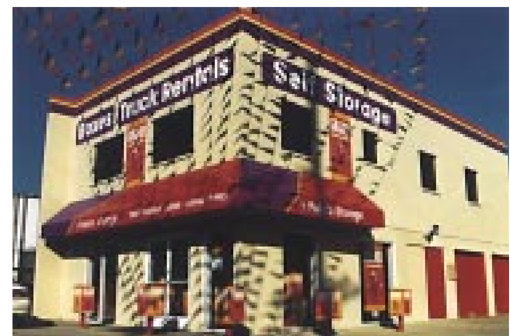
Under the Public Storage Umbrella



Self Storage. We offered over half a million self-storage spaces, encompassing about sixty-four million net rentable square feet, to the market at the end of 1996. At December 31, 1996, we had direct and indirect equity interests in 1,109 properties located in 38 states, including 1,064 self-storage facilities and 45 commercial properties. This level of market penetration, complemented by our property management system's practice of operating properties in groups in major markets, provided competitive advantages to Public Storage last year. We believe Public Storage enjoys strengths which are difficult to imitate and, as such, are competitive advantages. These strengths include a strong operating business, size and national presence, trade name, and financial solidity. Our mini-warehouses are our primary real estate product. We plan to continue finding ways to ensure that we maintain our position as the preeminent provider of quality mini-warehouse space in major metropolitan markets in the United States.

Container Storage. Public Storage Pickup & Delivery℠ (PSPUD) is our newest complementary business activity. Customers of this service enjoy certain benefits. Customers do not need to rent a truck or unload their possessions. PSPUD delivers a storage container to the customer's home or business. The container, made of wood, holds the items found in a typical living room. These containers feature removable center posts for easier access and locking hasps. Customers pack their items, lock the container and retain the key. We can provide any needed boxes and packing supplies. The customer takes as much time as needed to load the container. When finished, we will pick it up and transport it to our storage center. Customers can access their containers at any time during regular business hours at our storage center or we can deliver the container to their home or business.

Truck Rentals. Our truck rental operation meets the public's need for transportation of personal possessions. We currently have about 65 trucks available for rent in 45 locations. The trucks feature the amenities users demand, including automatic transmissions, low loading ramps, and air conditioning.



Retail Stores. Retail stores address additional aspects of a customer's relocation decision. Retail stores expand how Public Storage's mini-warehouses accommodate customers' needs. Tenants and other customers can purchase a variety of move-related merchandise, including corrugated boxes in a range of sizes, locks, packing supplies, and furniture covers. We are opening stores which are devoted primarily to selling these products, and have 13 so far. We have also converted 20 traditional mini-warehouses to offer enhanced retail products. Almost all newly constructed Public Storage mini-warehouses will feature a retail operation.

Maximizing Competitive Strengths

Sizeable, diversified customer base. At the end of 1996, 540,000 individuals and businesses comprised the Public Storage customer base. Our customers come from all walks of life. The majority of our customers can be categorized as commercial, residential, military and students. Since our customer base is broad, the Company avoids relying on a few major tenants or upon tenants in the same or similar business. Many of the Company's properties are located in areas possessing growing populations and diversified economies, which often result in strong self-storage demand. Moving, home downsizing, marriage, divorce, job loss and attending college are some of the events that trigger an individual's demand for self-storage space. Commercial users such as regional salesmen, small corporations and retailers use mini-warehouse properties to meet a multitude of record keeping and inventory storage needs.

Enhancing our competitive edge. The national reservation center augments our competitive edge by continuously offering our customers new and better services and products. We can market mini-warehouses, container storage, truck rentals, retail stores, and our HFS preferred-vendor marketing arrangement to customers through the national reservation center. A customer calling a property, or our Company's national toll-free number (1-800-44-STORE) can be connected with the center. The center currently receives about 120,000 calls per month. We plan to continue expanding the number of personnel staffing the reservation center and the product and services offered through it. We believe that improving and expanding upon our ability to increase customer demand has enabled us to support favorable occupancy trends through the national reservation center.

Change stimulates self-storage demand. Part of the expanding need for storage space in many of the Company's properties' markets and across America is linked to economic and social changes, such as population movement. In fact, planned and unplanned relocation activity is one of the most important generators of self-storage demand: 46,000 American households relocate on any given day. Many of the Company's properties are in locations that have about 100,000 people living in a five-mile marketing area around the property. The average city dweller moves every 7.5 years and will (according to the U.S. Postal Service) move 12 times in a lifetime. Accordingly, each year about 13,000 of the 100,000 people living within the market area of a typical Public Storage mini-warehouse may be seeking traditional or container self-storage and move-related supplies, a demand which the Company's properties can accommodate.

Simple construction/low costs yet high rental rates. Compare mini-warehouse construction costs to apartment costs and the resulting yield per square foot. The newly constructed Lake Forrest, California mini-warehouse featured throughout this annual report has an average per square foot rent of about $.92 a month. Surveys indicate a typical two bedroom apartment unit (approximately 1,000 square feet) in this property's market area rents for about the same amount on a square foot basis. However, the costs to construct this mini-warehouse property were, on a square foot basis, significantly less. The 10′ x 10′ unit in the photo is essentially a simple box made of tilt-up concrete, corrugated steel and a reinforced roll up door. Mini-warehouses require a low level of capital expenditure to maintain their condition and appearance. Moreover, capital outlays are usually not required after a tenant vacates. Additionally, repricing risks are minimized since tenancy is usually less than one year, enabling revenues to parallel current market conditions.

Consolidated Balance Sheets

(In thousands, except per share data) For the year ended December 31,	1996	1995
Assets		
Cash and cash equivalents	$ 26,856	$ 80,436
Real estate facilities, at cost:		
Land	596,141	382,144
Buildings	1,625,172	1,030,990
	2,221,313	1,413,134
Accumulated depreciation	(297,655)	(241,966)
	1,923,658	1,171,168
Investment in real estate entities	350,190	416,216
Intangible assets, net	222,253	231,562
Mortgage notes receivable from affiliates	25,016	23,699
Other assets	24,179	14,380
Total assets	$2,572,152	$1,937,461
Liabilities and Shareholders' Equity		
Notes payable	$ 108,443	$ 158,052
Accrued and other liabilities	41,467	32,533
Total liabilities	149,910	190,585
Minority interest	116,805	112,373
Commitments and contingencies		
Shareholders' Equity:		
Preferred Stock, $.01 par value, 50,000,000 shares authorized, 13,421,580 shares issued and outstanding (13,444,100 issued and outstanding at December 31, 1995), at liquidation preference:		
Cumulative Preferred Stock, issued in series	718,900	450,150
Convertible Preferred Stock	114,929	85,970
Common stock, $.10 par value, 200,000,000 shares authorized, 88,362,026 shares issued and outstanding (71,513,799 at December 31, 1995)	8,837	7,152
Class B Common Stock, $.10 par value, 7,000,000 shares authorized and issued	700	700
Paid-in capital	1,454,387	1,100,088
Cumulative net income	396,420	242,871
Cumulative distributions paid	(388,736)	(252,428)
Total shareholders' equity	2,305,437	1,634,503
Total liabilities and shareholders' equity	$2,572,152	$1,937,461

See accompanying notes.

Consolidated Statements of Income

(In thousands, except per share data) For each of the three years in the period ended December 31, 1996	1996	1995	1994
Revenues:			
Rental income:			
Self-storage facilities	$270,429	$184,100	$126,997
Commercial properties	23,576	18,034	14,848
Equity in earnings of real estate entities	22,121	3,763	764
Facility management fee	14,428	2,144	–
Ancillary business income	3,504	112	–
Interest and other income	7,064	4,497	4,587
	341,122	212,650	147,196
Expenses:			
Cost of operations:			
Self-storage facilities	82,494	63,396	45,266
Commercial properties	10,750	8,851	7,550
Cost of facility management	2,575	352	–
Cost of operations – ancillary business	3,418	100	–
Depreciation and amortization	64,967	40,760	28,274
General and administrative	5,524	3,982	2,631
Interest expense	8,482	8,508	6,893
Environmental cost	–	2,741	–
Advisory fee	–	6,437	4,983
	178,210	135,127	95,597
Income before minority interest	162,912	77,523	51,599
Minority interest in income	(9,363)	(7,137)	(9,481)
Net income	$153,549	$ 70,386	$ 42,118
Net income allocation:			
Allocable to preferred shareholders	$ 68,599	$ 31,124	$ 16,846
Allocable to common shareholders	84,950	39,262	25,272
	$153,549	$ 70,386	$ 42,118
Per Common Share:			
Net income	$ 1.10	$ 0.95	$ 1.05
Weighted average common shares outstanding	77,358	41,171	24,077

See accompanying notes.

Consolidated Statements of Shareholders' Equity

(In thousands, except share and per share amounts) For each of the three years in the period ended December 31, 1996	Preferred Stock	
	Cumulative	Convertible
BALANCES AT DECEMBER 31, 1993	$103,125	$ 57,500
Issuance of Preferred Stock, net of issuance costs:		
Series B, C and D (2,486,000 shares)	62,150	–
Issuance of Common Stock (10,770,437 shares)	–	–
Net income	–	–
Cash distributions:		
Preferred Stock	–	–
Common Stock, $0.85 per share	–	–
BALANCES AT DECEMBER 31, 1994	165,275	57,500
Issuance of Preferred Stock, net of issuance costs:		
Series E, F, G (4,501,900 shares)	284,875	–
Convertible Participating (31,200 shares)		28,470
Issuance of Common Stock (42,687,092 shares)	–	–
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
Issuance of Preferred Stock, net of issuance costs:		
Series H and I (10,750 shares)	268,750	–
Mandatory Convertible, Series CC (58,955 shares)	–	58,955
Issuance of Common Stock (15,134,241 shares)	–	–
Conversion of Mandatory Convertible Participating Preferred Stock into		
Common Stock (1,611,265 shares)	–	(28,470)
Conversion of 8.25% Convertible Preferred Stock into		
Common Stock (102,721 shares)	–	(1,526)
Net income	–	–
Cash distributions:		
Preferred Stock	–	–
Common Stock, $0.88 per share	–	–
BALANCES AT DECEMBER 31, 1996	$718,900	$114,929

See accompanying notes.

Common Stock	Class B Common Stock	Paid-in Capital	Cumulative Net Income	Cumulative Distributions	Total Shareholders' Equity
$1,806	$ –	$ 227,891	$130,367	$(144,623)	$ 376,066
–	–	(2,300)	–	–	59,850
1,077	–	146,770	–	–	147,847
–	–	–	42,118	–	42,118
–	–	–	–	(16,846)	(16,846)
–	–	–	–	(21,249)	(21,249)
2,883	–	372,361	172,485	(182,718)	587,786
–	–	(9,718)	–	–	275,157
					28,470
4,269	–	664,645	–	–	668,914
–	700	72,800	–	–	73,500
–	–	–	70,386	–	70,386
–	–	–	–	(31,124)	(31,124)
–	–	–	–	(38,586)	(38,586)
7,152	700	1,100,088	242,871	(252,428)	1,634,503
–	–	(8,972)	–	–	259,778
–	–	–	–	–	58,955
1,514	–	333,956	–	–	335,470
161	–	27,799	–	–	(510)
10	–	1,516	–	–	–
–	–	–	153,549	–	153,549
–	–	–	–	(68,599)	(68,599)
–	–	–	–	(67,709)	(67,709)
$8,837	$700	$1,454,387	$396,420	$(388,736)	$2,305,437

Consolidated Statements of Cash Flows

(In thousands) For each of the three years in the period ended December 31, 1996	1996	1995	1994
Cash Flows from Operating Activities:			
Net income	$ 153,549	$ 70,386	$ 42,118
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization (net of amortization of mortgage notes receivable discounts)	64,875	40,647	27,581
Depreciation included in equity in earnings of real estate entities	17,450	2,045	–
Environmental accrual (including $510 from equity in earnings of real estate entities)	–	3,251	–
Minority interest in income	9,363	7,137	9,481
Total adjustments	91,688	53,080	37,062
Net cash provided by operating activities	245,237	123,466	79,180
Cash Flows from Investing Activities:			
Principal payments received on mortgage notes receivable	1,784	2,063	6,785
Proceeds from disposition of real estate facilities, net	–	–	1,666
Acquisition of minority interests in consolidated real estate partnerships	(15,419)	(32,683)	(51,711)
Acquisition of mortgage notes receivable	(3,709)	(12,355)	(4,020)
Acquisition of real estate facilities	(198,404)	(108,326)	(93,026)
Acquisition cost of business combinations	(113,522)	(57,374)	(20,972)
Acquisition of interests in real estate entities	(83,893)	(20,657)	–
Construction in process	(46,097)	(7,979)	–
Capital improvements to real estate facilities	(20,366)	(11,361)	(8,312)
Net cash used in investing activities	(479,626)	(248,672)	(169,590)
Cash Flows from Financing Activities:			
Net paydowns on revolving line of credit	–	(37,607)	(10,323)
Net proceeds from the issuances of preferred stock	259,778	275,157	57,899
Net proceeds from the issuances of common stock	130,538	80,526	110,280
Principal payments on mortgage notes payable	(51,310)	(39,212)	(8,233)
Distributions paid to shareholders	(136,308)	(69,072)	(38,095)
Distributions from operations to minority interests in consolidated real estate partnerships	(20,853)	(18,380)	(23,037)
Net reinvestment by minority interests in consolidated real estate partnerships	3,976	(1,739)	7,962
Other	(5,012)	(4,182)	3,576
Net cash provided by financing activities	180,809	185,491	100,029
Net increase in cash and cash equivalents	(53,580)	60,285	9,619
Cash and cash equivalents at the beginning of the year	80,436	20,151	10,532
Cash and cash equivalents at the end of the year	$ 26,856	$ 80,436	$ 20,151

See accompanying notes.

(In thousands) For each of the three years in the period ended December 31, 1996	1996	1995	1994
Supplemental schedule of noncash investing and financing activities			
INVESTING ACTIVITIES:			
Acquisition of real estate facilities in exchange for common and preferred stock, the assumption of mortgage notes payable, the cancellation of mortgage notes receivable and the reduction of investment in real estate entities	$ (4,292)	$ (87,941)	$(42,656)
Business combinations (Note 3):			
Real estate facilities	(531,794)	(230,519)	(57,415)
Investment in real estate entities	124,696	(385,222)	–
Mortgage notes receivable	–	(6,667)	–
Other assets	(5,849)	(8,862)	(1,620)
Intangible assets	–	(232,726)	–
Accrued and other liabilities	15,399	17,134	695
Notes payable	–	96,728	–
Minority interest	20,139	17,034	–
Reduction of investment in real estate entities in exchange for real estate facilities	1,891	–	–
Acquisition of partnership interests in real estate entities in exchange for common stock	–	(4,034)	–
Reduction in other assets – deposits on pending real estate acquisitions	–	–	4,350
FINANCING ACTIVITIES:			
Cancellation of mortgage notes receivable to acquire real estate facilities	700	16,435	24,441
Assumption of mortgage notes payable upon the acquisition of real estate facilities	1,701	60,908	11,715
Accrued and unpaid distributions	–	638	–
Issuance of Preferred Stock:			
Series B Preferred Stock to acquire real estate facilities	–	–	2,150
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	204,932	573,756	37,369
Acquire real estate facilities	–	10,598	–
Acquire partnership interests in real estate entities	–	4,034	–
In connection with conversion of Convertible Preferred Stock	29,486	–	–
Issuance of Class B Common Stock in connection with mergers	–	73,500	–
Conversion of 8.25% Convertible Preferred Stock	(1,526)	–	–
Conversion of Mandatory Convertible Preferred Stock	(28,470)	–	–

See accompanying notes.

Notes to Consolidated Financial Statements

DECEMBER 31, 1996

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, to a lesser extent, also owns and operates commercial properties facilities 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. ("PSCP"), its business park facility 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 (Note 3).

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, 1996, the Company had direct and indirect equity interests in 1,109 properties located in 38 states, including 1,064 self-storage facilities and 45 commercial properties. All of these facilities are operated by the Company under the "Public Storage" name.

2. Summary of Significant Accounting Policies

Basis of presentation

The consolidated financial statements include the accounts of (i) the Company, (ii) majority-owned subsidiaries involved in the sale of locks and boxes, rental of trucks and portable self-storage, and (iii) twenty-one limited partnerships in which the Company has significant economic interest (generally in excess of 50%) and is able to exercise significant control (the "Consolidated Partnerships"). Collectively, the Company and the Consolidated Partnerships own a total of 756 real estate facilities, consisting of 721 self-storage facilities and 35 commercial properties.

The Company also has equity investments in 41 other affiliated limited partnerships and REITs owning in aggregate 353 real estate facilities (343 self-storage facilities and 10 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, accordingly, the Company's investments in these real estate 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 1996, 1995 and 1994; 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 interest rates approximate market rates for the type of real estate securing such 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, 1996 and 1995, intangible assets are net of accumulated amortization of $10,473,000 and $1,164,000, respectively. Included in depreciation and amortization expense is $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. Leasing commissions relating to the business park operations are expensed as incurred.

Environmental costs

The Company's policy is to accrue environmental assessments and/or remediation costs 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 Partnerships 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

Net income per common share is computed using the weighted average common shares outstanding (adjusted for stock options). The inclusion of the Class B Common Stock in the determination of earnings per common share has been determined to be anti-dilutive – after giving effect to the pro forma additional income required to satisfy certain contingencies (Note 11) required for the Class B common stock to convert into common stock – and, accordingly, the conversion of the Class B common stock into common stock has not been assumed.

The Company's preferred stocks (Note 11) were determined not to be common stock equivalents. In computing earnings per common share, preferred stock dividends totaling $68,599,000, $31,124,000 and $16,846,000 for the years ended December 31, 1996, 1995 and 1994, respectively, reduced income available to common stockholders.

Fully diluted earnings per common share are not presented, as the assumed conversion of the Company's convertible preferred stock (Note 11) would be anti-dilutive.

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.

Notes to Consolidated Financial Statements *(continued)*

Reclassifications

Certain reclassifications have been made to the consolidated financial statements for the years ended December 31, 1995 and 1994 in order to conform with the 1996 presentation.

3. BUSINESS COMBINATIONS

Mergers with affiliated REITs

During 1996, the Company completed merger transactions with eight 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:

		Merger consideration			
Entity	Date of merger	Common Stock	Cash	Pre-existing investment	Total
(In thousands)					
Public Storage Properties IX, Inc. ("Properties 9")	March 26, 1996	$ 24,719	$ 9,907	$12,937	$ 47,563
PS Business Parks, Inc. ("PSBP")	March 26, 1996	5,249	2,719	3,337	11,305
Storage Properties, Inc. ("SPI")	June 27, 1996	17,148	4,801	1,799	23,748
Public Storage Properties X, Inc. ("Properties 10")	September 16, 1996	26,012	14,178	9,333	49,523
Public Storage Properties XII, Inc. ("Properties 12")	September 16, 1996	33,157	7,436	9,472	50,065
Partners Preferred Yield, Inc. ("PPY"),	December 23, 1996	38,076	13,922	18,179	70,177
Partners Preferred Yield II, Inc. ("PPY-2")	December 23, 1996	41,790	13,692	18,077	73,559
Partners Preferred Yield III, Inc. ("PPY-3")	December 23, 1996	18,781	5,787	6,327	30,895
		$204,932	$72,442	$79,461	$356,835

During 1995, the Company completed merger transactions with two affiliated public REITs whereby the Company acquired all the outstanding stock of the REITs for an aggregate cost of $135,406,000, consisting of the issuance of 6,664,287 shares of the Company's common stock ($99,972,000) and $35,434,000 in cash. The fair market values of the assets acquired and liabilities assumed were: (i) real estate facilities – $140,775,000, (ii) other assets – $1,440,000, and (iii) accrued and other liabilities – $6,809,000.

Affiliated Partnership acquisitions:

During 1996, the Company increased its ownership interest in three affiliated limited partnerships. Prior to the acquisitions, the Company accounted for its investment in each of the three partnerships using the equity method. As a result of increasing its ownership interest and 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:

			Consideration paid to acquired Limited Partnership Units			
Entity	Percentage of Limited Partner Units Purchased	Date Purchased	Preferred Stock	Cash	The Company's Pre-existing investment	Total
(In thousands)						
PS Institutional Fund ("PSIF")	64%	March 1996	$ –	$41,080	$27,863	$ 68,943
Diversified Storage Fund ("Diversified")	100%	April 1996	39,410	–	11,565	50,975
Diversified Storage Fund II ("Diversified II")	100%	April 1996	19,545	–	5,807	25,352
			$58,955	$41,080	$45,235	$145,270

During 1995, the Company increased its ownership interest and control of twelve limited partnerships. As a result, commencing in 1995, the Company began to consolidate the accounts of these partnerships for financial statement purposes. The aggregate amount of the interests acquired totaled $48,410,000, consisting of the issuance of $28,470,000 of Mandatory Convertible Participating Preferred Stock and cash of $19,940,000.

PSMI merger

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. As a result of the PSMI Merger, the Company's name was changed from Storage Equities, Inc. to Public Storage, Inc.

The aggregate consideration paid by the Company for the net assets acquired in the PSMI Merger (including expenses of $2.0 million) was

$549,284,000, consisting of 29,449,513 shares of common stock ($473,784,000), 7,000,000 shares of Class B common stock ($73,500,000) (Note 11). The real estate operations acquired in the PSMI Merger included: (1) the "Public Storage" name, (2) general and limited partnership interests in 47 limited partnerships owning an aggregate of 286 self-storage facilities, (3) shares of common stock in 16 REITs owning an aggregate of 218 self-storage facilities and 14 business park properties, (4) seven wholly-owned properties, (5) all-inclusive deeds of trust secured by ten self-storage facilities, (6) property management contracts, exclusive of facilities owned by the Company, for 563 self-storage facilities and, through ownership of a 95% economic interest in a subsidiary, 24 business park properties and (7) a 95% economic interest in another subsidiary that currently sells locks and boxes in self-storage facilities operated by the Company.

Each of the above mergers with affiliated REIT's, acquisitions of partnership interests, and merger with PSMI 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 1996 and 1995 are summarized as follows:

(In thousands)	REIT mergers	Partnership Acquisitions	PSMI Merger	Total
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
1995 business combinations:				
Real estate facilities	$140,775	$ 69,801	$ 19,943	$230,519
Investments in real estate facilities	–	(4,464)	389,686	385,222
Mortgage notes receivable	–	–	6,667	6,667
Other assets	1,440	2,851	4,571	8,862
Intangible assets	–	–	232,726	232,726
Accrued and other liabilities	(6,809)	(701)	(9.624)	(17,134)
Notes payable	–	(3,387)	(93,341)	(96,728)
Minority interest	–	(15,690)	(1,344)	(17,034)
	$135,406	$ 48,410	$549,284	$733,100

The historical operating results of the above business combinations 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, 1996, 1995 and 1994 as though (i) business combinations and (ii) the public issuances of common and preferred stock (with the exception of the Series G, Series H, and Series I) during 1996, 1995 and 1994 and the use of the proceeds therefrom had been effective at the beginning of each period as follows:

	For the Year Ended December 31,		
(In thousands except per share data)	1996	1995	1994
Revenues	$378,718	$343,135	$354,936
Net income	$163,731	$129,829	$139,956
Net income per common share	$1.11	$1.10	$1.26

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 each period 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, (iii) estimated increase in depreciation and amortization expense, and (iv) elimination of advisory fee expense.

4. REAL ESTATE FACILITIES

Notes to Consolidated Financial Statements *(continued)*

Activity in real estate facilities during 1996, 1995 and 1994 is as follows:

(In thousands)	1996	1995	1994
Operating Facilities:			
Beginning balance	$1,405,155	$ 967,718	$ 764,126
Property acquisitions:			
Business combinations (Note 3)	531,794	230,519	57,415
Other acquisitions	202,696	191,002	135,682
Developed facilities	18,261	5,265	–
Acquisition of minority interest (Note 9)	7,226	(223)	4,820
Capital improvements	20,366	11,361	8,312
Property dispositions	–	(487)	(2,637)
Ending balance	2,185,498	1,405,155	967,718
Construction in progress:			
Beginning balance	7,979	–	–
Current development cost	46,097	13,244	–
Newly opened development facilities	(18,261)	(5,265)	–
Ending balance	35,815	7,979	–
Accumulated depreciation:			
Beginning balance	(241,966)	(202,745)	(175,621)
Additions during the year	(55,689)	(39,376)	(28,099)
Property dispositions	–	155	975
Ending balance	(297,655)	(241,966)	(202,745)
Total real estate facilities	$1,923,658	$1,171,168	$ 764,973

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).

Commencing in 1995, the Company began to construct self-storage facilities. Through December 31, 1996, the Company constructed and opened for operation five facilities, one of which began operations in August 1995 and four in 1996. Included in real estate facilities at December 31, 1996 is approximately $35,815,000 of costs related to the remaining 11 facilities under construction and the 17 additional facilities that the Company has plans to develop.

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 58 real estate facilities for an aggregate cost of $184,861,000 (including the facility developed in 1995), consisting of the cancellation of mortgage notes receivable ($16,435,000), the assumption of mortgage notes payable ($60,908,000) and cash ($107,518,000).

A substantial number of the real estate facilities acquired during 1996, 1995 and 1994 were acquired from affiliates with an aggregate acquisition cost of approximately $531,794,000, $300,193,000 and $119,211,000 respectively.

At December 31, 1996, the adjusted basis of real estate facilities for Federal income tax purposes was approximately $1,404.0 million, net of accumulated depreciation of $598.3 million.

5. Investments in Real Estate Entities

During 1996, the Company's equity in real estate entities decreased principally as a result of business combinations whereby the Company eliminated approximately $124.7 million of pre-existing equity in real estate entity investments. Offsetting this decrease were additional investments in numerous other unconsolidated affiliates for $83,893,000 in cash.

During 1995, the Company (i) acquired limited and general partnership interest 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). Prior to 1995, the Company's investment in real estate entities generally consisted of limited and general partnership interests in real estate limited partnerships which were accounted for using the cost method.

At December 31, 1996, the Company's investments in these real estate entities consist generally of ownership interests in 41 affiliated partner-

ships and common stock in eight affiliated REITs. Such interests consist of ownership interests ranging from 15% to 45% 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.

Equity in earnings of real estate entities for 1996 and 1995 principally consists of the Company's pro rata share of earnings for those interests acquired in the PSMI Merger. During 1996 and 1995, the Company recognized earnings from its investments of $22,121,000 and $3,763,000, respectively, and received cash distributions totaling $27,326,000 and $5,580,000, respectively. Included in equity in earnings of real estate entities for 1996 and 1995 is the Company's share of depreciation expense ($9,556,000 and $926,000, respectively) and environmental costs ($510,000 in 1995, none in 1996) of the real estate entities. In addition, equity in earnings of real estate entities includes amortization totaling $7,894,000 in 1996 and $1,119,000 in 1995 (from date of the PSMI Merger through the end of the year) representing the amortization of the Company's cost basis over the underlying book value of the Company's equity interest in each of the entities. At December 31, 1996, the unamortized excess of the Company's investment over its equity in the underlying net assets of these real estate entities at the date of acquisition was approximately $154.5 million.

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, 1996 are as follows:

	Year ended December 31,	
(In thousands)	1996	1995
Rental income	$180,197	$172,675
Total revenues	182,036	175,150
Cost of operations	65,417	62,542
Depreciation	27,332	27,368
Net income	75,937	69,467
Total assets, net of accumulated depreciation	834,695	839,775
Total debt	89,349	95,305
Total equity	710,118	708,768

6. Mortgage Notes Receivable From Affiliates

At December 31, 1996, mortgage notes receivable of $25,016,000 bear interest at stated rates ranging from 7.4% to 14.0% and are secured by 13 self-storage facilities owned by affiliates of the Company.

During 1996, the Company acquired a $1,970,000 mortgage note receivable from a third party (secured by a self-storage facility) and provided loans totaling $1,739,000 to affiliated limited partnerships. During 1995, in connection with the PSMI Merger, the Company acquired mortgage notes receivable totaling $6,667,000 which are secured by self-storage facilities owned by affiliated entities.

The Company canceled mortgage notes with a net carrying value of $700,000 and $16,435,000 during 1996 and 1995, respectively, as part of the acquisition cost of the underlying real estate facilities securing the mortgage notes (Note 4).

7. Revolving Line of Credit

As of December 31, 1996, the Company had no borrowings on its unsecured credit agreement with a group of commercial banks. On February 25, 1997, the credit agreement was amended (the "Credit Facility") to increase the available borrowings to $150.0 million and extend the expiration date to 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, 1996.

Notes to Consolidated Financial Statements *(continued)*

8. NOTES PAYABLE

Notes payable at December 31, 1996 and 1995 consist of the following:

	1996		1995	
(In thousands)	Carrying amount	Fair value	Carrying amount	Fair value
7.08% unsecured senior notes, due November 2003	$ 59,750	$ 59,750	$ 65,500	$ 65,500
Mortgage notes payable:				
10.55% mortgage notes secured by real estate facilities, principal and interest payable monthly, due August 2004	32,115	34,964	33,699	36,959
7.07% to 11.10% mortgage notes secured by real estate facilities, principal and interest payable monthly, due at varying dates between December 1997 and September 2028	16,578	16,578	22,875	22,875
Variable rate mortgage notes secured by real estate facilities	–	–	35,978	35,978
	$108,443	$111,292	$158,052	$161,312

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, 1996.

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 30 of the Company's real estate facilities having an aggregate net book value of $68.1 million at December 31, 1996.

At December 31, 1996, approximate principal maturities of notes payable are as follows:

(in thousands)	7.08% Unsecured Senior Notes	Fixed Rate Mortgage Debt (weighted average rate of 10.28%)	Total
1997	$ 6,500	$ 4,744	$ 11,244
1998	7,250	7,908	15,158
1999	8,000	6,484	14,484
2000	8,750	2,721	11,471
2001	9,500	2,238	11,738
Thereafter	19,750	24,598	44,348
	$59,750	$48,693	$108,443

Interest paid (including interest related to the borrowings on the Credit Facility) during 1996, 1995 and 1994 was $10,312,000, $8,595,000 and $5,940,000, respectively. In addition, in 1996 and 1995, the Company capitalized interest totaling $1,861,000 and $307,000, respectively, related to construction of real estate facilities.

9. MINORITY INTEREST

In consolidation, the Company classifies ownership interests other than its own in the net assets of each of the Consolidated Partnerships 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 Partnerships.

During 1996, the Company acquired limited partnership interests in the Consolidated Partnerships in several transactions for an aggregate cost of $15,419,000. These transactions had the effect of reducing minority interest by approximately $8,193,000 (the historical book value of such interests in the underlying net assets of the partnerships). The excess of the underlying book value over cost ($7,226,000) has been allocated to real estate facilities in consolidation. In 1995 and 1994, the Company acquired interests in the Consolidated Partnerships at an aggregate cost of $32,683,000 and $51,711,000, respectively, reducing minority interest by approximately $32,906,000 and $46,891,000, respectively. The excess of cost over underlying book values was allocated to real estate facilities in consolidation.

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

10. 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 in 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 business park facilities operated. Management fees relating to the Company's real estate facilities, which are included in cost of operations, amounted to $10,232,000 and $8,355,000 in 1995 and 1994, respectively. During 1994 and 1995 (from January 1, 1995 through November 16, 1995), the Company paid advisory fees equal to $4,983,000 and $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 of a 95% economic interest 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, 1996, the Company managed 1,101 self-storage facilities (721 owned by consolidated facilities, 343 owned by unconsolidated affiliates and 37 owned by third parties) and 45 commercial properties (35 owned by consolidated facilities and 10 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.

11. Shareholders' Equity

Preferred Stock

At December 31, 1996 and 1995, the Company had the following series of Preferred Stock outstanding:

		At December 31, 1996		At December 31, 1995	
Series	Dividend Rate	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	8.45%	6,750	168,750,000	–	–
Series I	8.625%	4,000	100,000,000	–	–
Total Senior Preferred Stock		11,123,650	718,900,000	11,112,900	450,150,000
Convertible	8.25%	2,238,975	55,974,000	2,300,000	57,500,000
Mandatory Convertible – Series CC	13.00%	58,955	58,955,000	–	–
Mandatory Convertible Participating	Variable	–	–	31,200	28,470,000
Total Convertible Preferred Stock		2,297,930	114,929,000	2,331,200	85,970,000
		13,421,580	$833,829,000	13,444,100	$536,120,000

During 1996, the Company issued 6,750,000 depositary shares (depositary 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 depositary shares (depositary shares, each representing 1/1,000 of a share) of its 8⅝% 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"). The Series CC Preferred Stock ranks junior to the Company's Cumulative Senior Preferred Stock with respect to general preference rights and has a liquidation value of $1,000 per share. Other significant

Notes to Consolidated Financial Statements *(continued)*

terms of the Series CC Preferred Stock include: (i) quarterly distributions equal to $32.50 per share, (ii) conversion, at anytime at the option of the holder, into common stock of the Company at a conversion price of $28.56 or 35.014 shares of common stock for each share of Series CC Preferred Stock, and (iii) automatic conversion into common stock of the Company on March 31, 2000 at the conversion price described above.

During the second quarter of 1996, the Mandatory Convertible Participating Preferred Stock was exchanged into 1,611,265 shares of common stock. Costs incurred in connection with the exchange have been charged to Paid in Capital.

The Series A through Series I (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, 1996, there were no dividends in arrears and the Debt Ratio was 4.2%.

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. 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 depositary share in the case of the Series H and Series I), 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 1996, 1995 and 1994, the Company issued shares of its common stock as follows:

	1996		1995		1994	
(Dollar amounts in thousands)	Shares	Amount	Shares	Amount	Shares	Amount
Public offerings	6,151,200	$127,501	5,482,200	$ 82,068	7,984,000	$108,083
In connection with mergers (Note 3)	8,839,181	204,932	36,113,800	573,756	2,593,914	38,498
Issuance costs of mergers	–	–	–	(2,527)	–	(1,124)
Exercise of stock options	100,663	2,037	46,670	403	82,666	689
Issuance to affiliates	43,197	1,000	40,000	582	109,857	1,701
Conversion of Mandatory Convertible Preferred Stock	1,611,265	27,960	–	–	–	–
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	102,721	1,526	–	–	–	–
	16,848,227	$364,956	42,687,092	$668,914	10,770,437	$147,847

Shares of common stock issued to affiliates in 1996, 1995 and 1994 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, 1996, the Company had 5,250,004 shares of common stock reserved in connection with the Company's stock option plans (Note 12) and 12,834,000 shares of common stock reserved for the conversion of the Convertible Preferred Stock, Class B Common Stock and Series CC convertible preferred stock.

On March 18, 1997, the Company publicly issued 4,600,000 shares of common stock, raising net proceeds of approximately $126.5 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 $1.86 for the year ended December 31, 1996.

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. At December 31, 1996, the Company had no outstanding shares of Equity Stock.

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 1996, 1995 and 1994 were characterized as ordinary income.

The following summarizes dividends paid during 1996, 1995 and 1994 (with the exception of the Series G Preferred Stock distributions which were accrued and unpaid at December 31, 1995):

	1996		1995		1994	
(In thousands, except per share data)	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	5,340
Series C	1.840	2,212	1.970	2,364	1.042	1,250
Series D	2.375	2,850	2.375	2,850	0.792	950
Series E	2.500	5,488	2.292	5,030	–	–
Series F	2.437	5,606	1.618	3,721	–	–
Series G	2.219	15,479	0.092	638	–	–
Series H	1.978	13,348	–	–	–	–
Series I	.359	1,438	–	–	–	–
Convertible	2.063	4,679	2.063	4,744	2.063	4,743
Series CC	97.500	5,748	–	–	–	–
Mandatory Convertible Participating	$54.487	1,700	$55.322	1,726	–	–
		68,599		31,124		16,846
Common	$ 0.880	67,709	$ 0.880	38,586	$ 0.850	21,249
		$136,308		$69,710		$38,095

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

Notes to Consolidated Financial Statements *(continued)*

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 1997 will be equal to 7.26% 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.

12. 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 1996 and 1995 is as follows:

	1996		1995	
	Number of Options	Average Price per Share	Number of Options	Average Price per Share
Options outstanding January 1	693,667	$13.61	512,834	$11.88
Granted	1,183,000	21.39	227,500	16.48
Exercised	(100,663)	10.29	(46,667)	8.63
Canceled	(23,835)	16.02	–	–
Options outstanding December 31	1,752,169	$19.02	693,667	$13.61
Option price range at December 31	$8.125 to 25.875		$8.125 to $18.00	
Options exercisable at December 31	367,947	$13.05	302,485	$10.89
Options available for grant at December 31	3,497,835		807,000	

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, 1996 and 1995, there were 1,391,500 and 208,500 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, 1996 and 1995. The remaining contractual lives were 8.6 and 7.2 years, respectively, at December 31, 1996 and 1995.

13. Proposed Mergers

In December 1996, Public Storage Properties XIV, Inc. ("Properties 14") and Public Storage Properties XV, Inc. ("Properties 15") each agreed, subject to certain conditions, to merge with and into the Company. Properties 14 and Properties 15 are affiliated publicly traded equity REITs. Each of the mergers is conditioned on approval by the respective shareholders of Properties 14 and Properties 15. However, the mergers are not conditioned on approval of each other. The Company expects that if approved by the shareholders the mergers would be completed in April 1997.

The estimated value of the Properties 14 and Properties 15 merger is approximately $63.8 million and $58.5 million, respectively. Properties 14 and Properties 15 own 14 properties (912,000 square feet) and 19 properties (1,087,000 square feet), respectively. The Company currently owns approximately 33% and 35% of the economic interest in Properties 14 and Properties 15, respectively.

14. Restructuring of Commercial Properties Operations

Effective January 2, 1997, the Company restructured its commercial property operations by forming a new private REIT that will concentrate its investing efforts in real estate facilities containing commercial and industrial rental space. The Company's majority-owned subsidiary, Public Storage Commercial Properties Group, Inc. (which subsequently changed its name to American Office Park Properties, Inc.), its commercial property manager, contributed all its property management contracts to a newly created operating partnership in exchange for the general partnership interest. The Company and the Consolidated Partnerships contributed substantially all of their commercial properties to the operating partnership in exchange for limited partnership interests. The limited partnership interests, pursuant to the terms and conditions of the governing documents, are convertible into shares of common stock of American Office Park Properties, Inc. American Office Park Properties, Inc. intends to elect to operate as a REIT as defined in Section 856 of the Internal Revenue Code effective January 1, 1997. The restructuring will not immediately impact total assets, shareholders' equity, or the operations of the company.

The Company believes that the concentration of all the business park facilities 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 and the affiliates exchanging real estate assets to the new REIT will participate in the growth through its ownership interest in the new REIT.

15. Supplementary Quarterly Financial Data (Unaudited)

	Three months ended			
(In thousands, except per share data)	March 31, 1996	June 30, 1996	September 30, 1996	December 31, 1996
Revenues	$74,967	$83,133	$88,103	$94,919
Net income	$32,341	$37,739	$40,366	$43,103
Per Common Share (Note 2):				
Net income	$0.24	$0.27	$0.30	$0.29

	Three months ended			
(In thousands, except per share data)	March 31, 1996	June 30, 1996	September 30, 1996	December 31, 1996
Revenues	$43,198	$47,912	$56,938	$64,602
Net income	$13,200	$16,551	$19,470	$21,165
Per Common Share (Note 2):				
Net income	$0.24	$0.26	$0.26	$0.20

Revenues for each of the three month periods in 1996 and 1995 reflect reclassification to conform with the fiscal 1996 presentation. The three months ended December 31, 1995 reflects the effects of the PSMI Merger.

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, 1996 and 1995, and the related consolidated statements of income, shareholders' equity, and cash flows for each of the three years in the period ended December 31, 1996. 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, 1996 and 1995, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 1996, in conformity with generally accepted accounting principles.

Ernst & Young LLP

Los Angeles, California

February 25, 1997

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:

Over the past three years, the Company has effected several business initiatives which have had, and should continue to have, significant effects on the Company's results of operations and financial condition. The Company's asset base has expanded rapidly through the acquisition of additional real estate investments which have principally been financed through the issuance of permanent capital in the form of common and preferred stock and the retention of operating cash flow. Since 1993, the Company's total assets and shareholders' equity have increased significantly as total assets increased from $666.1 million at December 31, 1993 to $2.6 billion at December 31, 1996, and shareholders' equity increased from $376.1 million at December 31, 1993 to $2.3 billion at December 31, 1996. Among the more significant transactions that the Company completed during 1994, 1995 and 1996 are summarized as follows:

- ***Increased interests in real estate facilities:*** Through the acquisition of wholly-owned facilities and the acquisition of interests in real estate entities, the Company's ownership interest in real estate facilities has increased from 331 facilities at the end of 1993 to 1,109 facilities at the end of 1996.
- ***Mergers with affiliated REITs***: Since 1993, the Company has completed eleven mergers with affiliated REITs: one in 1994 with an aggregate cost of $55.8 million, two in 1995 with an aggregate cost of $135.4 million, and eight in 1996 with an aggregate cost of $356.8 million.
- ***Became self-advised and self-managed:*** On November 16, 1995, the Company became self-advised and self-managed in connection with the merger with Public Storage Management, Inc. ("PSMI") with an aggregate cost of $549.3 million. In the merger with PSMI (the "PSMI Merger"), the Company acquired all the real estate operations of PSMI, including (i) general and limited partnership interests in 47 limited partnerships owning an aggregate of 286 self-storage facilities, (ii) shares of common stock in 16 REITs owning an aggregate of 218 self-storage facilities and 14 commercial properties, (iii) seven wholly-owned properties, (iv) all-inclusive deeds of trust secured by 10 self-storage facilities, (v) property management contracts, exclusive of facilities owned by the Company, for 563 self-storage facilities and through ownership of a 95% economic interest in a subsidiary, 24 commercial properties and (vi) a 95% economic interest in another subsidiary that currently sells locks and boxes in self-storage facilities operated by the Company.
- ***Issuance of capital stock:*** To fund the Company's acquisition activities over the past three years the Company has issued approximately $592.8 million of preferred stock and $321.3 million of common stock in public offerings, and approximately $87.4 million of preferred stock and $830.7 million of common stock in connection with mergers and real estate acquisitions.
- ***Development activities:*** In 1995, the Company commenced development of self-storage facilities, opening one in 1995 and four in 1996, with eleven under construction at December 31, 1996.
- ***Portable self-storage business:*** In August 1996, the Company commenced operations in the portable self-storage business facilitated by the acquisition of an existing operator. As of December 31, 1996, the Company opened three new facilities. From December 31, 1996 through March 15, 1997 the Company opened an additional eight facilities.

The significant increases in both the Company's asset and capital base have translated into significant growth in the Company's overall operating results. The comparative growth in operating results between 1996 and 1995 is principally due to the impact of the PSMI Merger combined with mergers with affiliated REITs. The comparative growth in operating results between 1995 and 1994 is principally due to mergers with affiliated REITs combined with acquisitions of additional real estate facilities and investments in real estate entities.

RESULTS OF OPERATIONS

Net income and earnings per common share: Net income for 1996, 1995 and 1994 was $153,549,000, $70,386,000 and $42,118,000, respectively, representing increases over the prior year of 118.2% for 1996 and 67.1% for 1995. Net income allocable to common shareholders (net income less preferred stock dividends) for 1996, 1995 and 1994 was $84,950,000, $39,262,000 and $25,272,000, respectively, representing increases over the prior year of 116.4% for 1996 and 55.4% for 1995. On a per share basis, net income was $1.10 per share (based on weighted average shares outstanding of 77,358,000) for 1996, $0.95 per share (based on weighted average shares outstanding of 41,171,000) for 1995 and $1.05 per share (based on weighted average shares outstanding of 24,077,000) for 1994. The increase in net income per share for 1996 compared to 1995 was the result of improved real estate operations. The 1996 per share amount also reflects earnings dilution caused by (i) development activities ($0.02 per share), (ii) portable self storage operations ($0.01 per share) and (iii) the temporary uninvested net offering proceeds ($0.02 per share) from the issuance of the Series H and Series I preferred stock. The decrease in net income per share for 1995 compared to 1994 was principally due to increasing depreciation expense combined with the accrual of estimated environmental remediation costs at the end of 1995 and a greater number of shares outstanding in 1995.

Net income includes depreciation and amortization expense (including depreciation included in equity in earnings of real estate entities) of approximately $70,835,000 ($0.92 per common share) for 1996, $31,449,000 ($0.76 per common share) for 1995, and $14,025,000 ($0.58 per

Management's Discussion and Analysis of Financial Condition and Results of Operations *(continued)*

common share) for 1994. 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).

The Company's business operations consist of its (i) self-storage properties, (ii) commercial properties, (iii) property management activities and (iv) ancillary operations, including the Company's portable self-storage operations. The Company's real estate operations account for substantially all of the Company operating activities. During 1996, approximately 94% of the Company's sources of operating income (income prior to deductions for depreciation, general and administrative expenses, advisory fees and interest expense) was generated from property operations.

REAL ESTATE OPERATIONS

At December 31, 1996, the Company's investment portfolio consisted of (i) its wholly-owned properties, (ii) properties owned by real estate partnerships consolidated with the Company (the "Consolidated Partnerships") and (iii) properties owned by real estate entities (partnerships and REITs) 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, 1996:

	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	429	21	450	26,355	1,503	27,858
Facilities owned by Consolidated Partnerships	292	14	306	17,062	1,542	18,604
Total consolidated facilities	721	35	756	43,417	3,045	43,462
Facilities owned by Unconsolidated Entities	343	10	353	20,600	673	21,273
Total facilities in which the Company has an ownership interest	1,064	45	1,109	64,017	3,718	64,735

The facilities in which the Company has an ownership interest are located in or near major metropolitan markets in 38 states. The Company believes that geographic diversity reduces the impact from regional economic downturns and provides a greater degree of stability to revenues.

Self-storage operations: Self-storage rental income and cost of operations presented on the consolidated statements of income reflect the operations of the 721 self-storage facilities owned by the Company and the Consolidated Partnerships. The following table summarizes the operating results (before depreciation) of these facilities for each of the past three years:

SELF-STORAGE OPERATIONS:

	Year Ended December 31,			Year Ended December 31,		
(Dollar amounts in thousands, except rents per square foot)	1996	1995	Percentage Change	1995	1994	Percentage Change
Rental income:						
Consistent group	$121,481	$116,587	4.2%	$116,587	$112,763	3.4%
Post-1993 acquisitions	148,948	67,513	120.6%	67,513	14,234	374.3%
	270,429	184,100	46.9%	184,100	126,997	45.0%
Cost of operations:						
Consistent group	37,438	40,319	(7.2)%	40,319	40,246	0.2%
Post-1993 acquisitions	45,056	23,077	95.2%	23,077	5,020	359.7%
	82,494	63,396	30.1%	63,396	45,266	40.1%
Net operating income:						
Consistent group	84,043	76,268	10.2%	76,268	72,517	5.2%
Post-1993 acquisitions	103,892	44,436	133.8%	44,436	9,214	382.3%
	$187,935	$128,704	55.7%	$120,704	$ 81,731	47.7%
Consistent group data:						
Gross margin	69.2%	65.4%	5.8%	65.4%	64.3%	1.7%
Weighted average occupancy	90.7%	89.8%	1.0%	89.8%	90.0%	(0.2)%
Average realized annual rent per square foot	$7.68	$7.44	3.2%	$7.44	$7.08	5.1%
Average scheduled annual rent per square foot	$7.80	$7.20	8.3%	$7.20	$6.84	5.3%
Number of facilities (at the end of the period):						
Consistent group	298	298	–	298	298	–
Cumulative post-1993 acquisitions	423	222	90.5%	222	67	231.3%
Net rentable square feet (at the end of the period):						
Consistent group	17,641	17,641	–	17,641	17,641	–
Cumulative post-1993 acquisitions	25,776	13,137	96.2%	13,137	4,166	215.3%

The comparative increases in the Company's self-storage operations from 1994 through 1996 are principally due to the acquisition of additional facilities as indicated in the above table. For the consistent group of facilities owned throughout each of the three fiscal years, year-over-year improvements in rental income of 4.2% in 1996 and 3.4% in 1995 are principally the result of increased realized rent per square foot and, with respect to fiscal 1996, increased weighted average occupancy levels.

Commencing in early 1996, the Company began to experiment with 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 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. The national telephone reservation system, which is no longer experimental, was not fully operational for most of the Company's facilities until the fourth quarter of 1996 and is currently handling in excess of 100,000 calls per month. As of December 31, 1996, the national telephone reservation system was supporting rental activity at all of the Company's properties, with the exception of one major market, which was included in March 1997.

In connection with the national telephone reservation system, the Company experimented with pricing and promotional discounts designed to increase rental activity. As a result, promotional discounts increased significantly. Rental income for the Company's self-storage facilities is net of promotional discounts totaling $4,031,000 and $303,000 for the years ended December 31, 1996 and 1995, respectively. The Company believes that the use of the national telephone reservation system combined with rental discounts has resulted in increased weighted average occupancies.

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 1996, both realized and scheduled rents per square foot increased compared to 1995. This trend was also applicable throughout the portfolio of self-storage facilities in which the Company has an ownership interest and manages (see "Supplemental Property Data" below).

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 operation for 1995 and 1994 were management fees totaling $9,421,000 and $7,587,000, respectively ($5,966,000 in 1995 and $6,737,000 in 1994 with respect to the consistent group of facilities). However, offsetting the decrease in property management fees in 1996 are expenses with respect to the national telephone reservation system totaling $1,257,000.

Development of self-storage facilities: Commencing in 1995, the Company began to construct self-storage facilities. Through December 31, 1996, the Company constructed and opened for operation five facilities, one of which began operations in August 1995 and four in 1996. At December 31, 1996, the Company had eleven self-storage facilities (approximately 707,000 square feet) under construction with an aggregate cost incurred to date of approximately $33.5 million and total additional estimated cost to complete of $22.5 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 a stabilized occupancy level of approximately 90%. Due to the timing of the employment of the capital to construct the facilities and the relatively long "fill-up" period until the facilities reach a stabilized occupancy level, the Company believes that its development plans may create earnings dilution in the short-term. However, the Company has reached an agreement in principle to develop approximately $220 million of self-storage facilities with a joint venture partner (see ***"Liquidity and Capital Resources – Development activities"***) and expects that the joint development of self-storage facilities will mitigate this earnings dilution to the extent of the joint venturer's interest.

Management's Discussion and Analysis of Financial Condition and Results of Operations *(continued)*

Commercial property operations: Commercial property rental income and cost of operations presented on the consolidated statements of income reflect the operations of the 35 facilities owned by the Company and the Consolidated Partnerships. The following table summarizes the operating results (before depreciation) of these facilities for each of the past three years:

Commercial Property Operations:

	Year Ended December 31,			Year Ended December 31,		
(Dollar amounts in thousands, except rents per square foot)	1996	1995	Percentage Change	1995	1994	Percentage Change
Rental income:						
Consistent group	$14,685	$14,689	–	$14,689	$14,144	3.9%
Post-1993 acquisitions	8,891	3,345	165.8%	3,345	704	375.1%
	23,576	18,034	30.7%	18,034	14,848	21.5%
Cost of operations:						
Consistent group	7,260	7,305	(0.6)%	7,305	7,269	0.5%
Post-1993 acquisitions	3,490	1,546	125.7%	1,546	281	450.2%
	10,750	8.851	21.5%	8.851	7,550	17.2%
Net operating income:						
Consistent group	7,425	7,384	0.6%	7,384	6,875	7.4%
Post-1993 acquisitions	5,401	1,799	200.2%	1,799	423	325.3%
	$12,826	$ 9,183	39.7%	$ 9,183	$ 7,298	25.8%
Consistent group data:						
Gross margin	50.6%	50.3%	0.6%	50.3%	48.6%	3.4%
Weighted average occupancy	96.0%	96.3%	(0.3)%	96.3%	95.0%	1.3%
Average realized annual rent per square foot	$8.64	$8.64	–	$8.64	$8.28	4.4%
Number of facilities (at the end of the period):						
Consistent group	15	15	–	15	15	–
Cumulative post-1993 acquisitions	19	5	280.0%	5	1	400.0%
Net rentable square feet (at the end of the period):						
Consistent group	1,696	1,696	–	1,696	1,696	–
Cumulative post-1993 acquisitions	1,041	308	238.0%	308	195	57.9%

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 operations of the consistent group of properties over the past three years has been relatively stable, with changes in operations principally the result of changing occupancy levels and realized rental rates. Due to the size of the Company's investment in commercial properties relative to its self-storage facilities, the Company has not emphasized its growth in this segment of its portfolio.

Effective January 2, 1997, the Company restructured its commercial property operations to concentrate its investing efforts in real estate facilities containing commercial and industrial rental space through a separate entity. See Note 14 to the consolidated financial statements. The Company believes that restructuring will create a vehicle which should facilitate future growth in this segment of the real estate industry. The Company will participate in this growth through its ownership interest in the new entity. The Company currently owns approximately 85% of the economic interest in the new entity. Accordingly, due to the Company's significant ownership interest the Company will continue to consolidate the entity until such time that the Company's ownership and control is reduced to a level not warranting consolidation.

Equity in earnings of real estate entities: As of December 31, 1996, the Company had ownership interests in 41 affiliated limited partnerships and eight affiliated REITs which comprise the Unconsolidated Entities. The Company's ownership interest in these entities ranges from 15% to 45%, but generally averages approximately 30%. 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 353 real estate facilities, 343 of which are self-storage facilities. The following table summarizes the components of the Company's equity in earnings of real estate entities:

	Year Ended December 31,			Year Ended December 31,		
(Amounts in thousands)	1996	1995	Dollar Change	1995	1994	Dollar Change
Self-storage operations	$ 41,722	$ 6,573	$ 35,149	$ 6,573	$764	$ 5,809
Commercial property operations	2,667	269	2,398	269	-	269
Depreciation:						
Self-storage facilities	(15,709)	(1,909)	(13,800)	(1,909)	-	(1,909)
Commercial properties	(1,741)	(136)	(1,605)	(136)	-	(136)
Other[(1)]	(4,818)	(1,034)	(3,784)	(1,034)	-	(1,034)
Total equity in earnings of real estate entities	$ 22,121	$ 3,763	$ 18,358	$ 3,763	$764	$ 2,999

[(1)]Principally the Company's pro rata share of general and administrative expense and interest expense.

The increase in 1995 earnings compared to 1994 is principally the result of the acquisition of ownership interests in the Unconsolidated Entities acquired pursuant to the PSMI Merger. The increase in earnings in 1996 compared to 1995 is due to (i) the 1996 earnings reflect 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 acquired 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 was 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 1996 with respect to those Unconsolidated Entities in which the Company had an ownership interest as of December 31, 1996:

Rental income	$180,197,000
Total revenues	182,036,000
Cost of operations	65,417,000
Depreciation	27,332,000
Net income	75,937,000

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 ownership of a 95% economic interest in 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, 1996, the Company managed 1,101 self-storage facilities (1,064 owned by affiliates of the Company and 37 owned by third parties) and 45 commercial properties, all of which are owned by 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.

Management's Discussion and Analysis of Financial Condition and Results of Operations *(continued)*

Property Management Operations:

(Amounts in thousands)	Year Ended December 31, 1996	1995	Dollar Change	Year Ended December 31, 1995	1994	Dollar Change
Facility management fees:						
Self-storage	$13,474	$1,976	$11,498	$1,976	$ –	$1,976
Commercial properties	954	168	786	168	–	168
	14,428	2,144	12,284	2,144	–	2,144
Cost of operations:						
Self-storage	1,820	264	1,556	264	–	264
Commercial properties	755	88	667	88	–	88
	2,575	352	2,223	352	–	352
Net operating income:						
Self-storage	11,654	1,712	9,942	1,712	–	1,712
Commercial properties	199	80	119	80	–	80
	$11,853	$1,792	$10,061	$1,792	$ –	$1,792

Because the Company has significant ownership interests in all but 37 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 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 1997 compared to 1996. The acquisitions of such facilities will reduce management fee income. However, offsetting the reduction in management fee income will be a corresponding reduction in the cost of property operations as the facilities acquired by the Company will no longer incur property management fees.

Ancillary Businesses

Although not material to the Company's overall operations, its ancillary business is expected to play a more important role in the future of the Company. The following table summarizes the Company's ancillary business operations:

(Amounts in thousands)	Year Ended December 31, 1996	1995	Dollar Change	Year Ended December 31, 1995	1994	Dollar Change
Ancillary revenues:						
Sales of locks, boxes and packaging material	$2,540	$101	$2,439	$101	$ –	$101
Truck rental income	543	11	532	11	–	11
Portable self-storage rents	421	–	421	–	–	–
	3,504	112	3,392	112	–	112
Cost of operations – ancillary business						
Locks, boxes and package materials	1,660	84	1,576	84	–	84
Truck rentals	511	16	495	16	–	16
Portable self-storage	1,247	–	1,247	–	–	–
	3,418	100	3,318	100	–	100
Net operating income (loss) – ancillary business						
Locks, boxes and package materials	880	17	863	17	–	17
Truck rentals	32	(5)	37	(5)	–	(5)
Portable self-storage	(826)	–	(826)	–	–	–
	$ 86	$ 12	$ 74	$ 12	$ –	$ 12

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 to 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 (i) a retail expansion program, (ii) truck rental program and more importantly (iii) a portable self-storage business.

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.

In 1996, the Company organized Public Storage Pickup & Delivery, Inc. ("PSPUD") as a separate corporation to operate a portable self-storage business that rents storage containers to customers for storage in central warehouses and provides related transportation services. The Company believes PSPUD's business complements the Company's existing operations and PSPUD is using the national telephone reservation system and various marketing initiatives, including radio and television, to promote its rental activity. PSPUD currently operates a total of 12 facilities in six greater metropolitan areas in California and Texas. PSPUD anticipates opening four additional facilities in these areas and in three additional areas by the end of the first quarter of 1997. PSPUD presently anticipates expanding its operations to a significant number of additional areas during the remainder of 1997 and 1998, subject to continuing evaluation of this business and the satisfaction of regulatory requirements. There can be no assurance on the level of PSPUD's expansion or profitability.

Although not material to the Company's 1996 operating results, the Company expects that this business will have a material impact on the Company during 1997 and beyond. Generally, PSPUD expects to expend an amount ranging from $850,000 to $1,100,000 per facility during the first full year of operations, depending on location and pricing structure. This estimate includes approximately $550,000 of capitalized expenditures and assumes (i) a leased facility for 2,000 storage containers, (ii) a break-even occupancy level of 55% to 65%, (iii) a stabilized occupancy level of 90% reached in 9 to 12 months, and (iv) monthly rental rates ranging from $35.00 to $45.00 per container. Rental rates will vary based on location and market conditions. Most of the operating costs of a facility are expected to be fixed. However, certain fixed costs are expected to be reduced as the facility reaches a stabilized occupancy level and certain economies of scale are expected to be achieved as the number of facilities in operation grows.

PSPUD's operating experience is limited and its operations may be affected by such factors as the level of competition in the business, the demand for storage containers, general economic conditions, either nationally or in the market areas in which PSPUD operates, the rate of facility move-ins and move-outs, the availability of acceptable locations, the level of PSPUD's operating expenses and the cost of capital equipment. Until the facilities are operating profitably, PSPUD's operations are expected to adversely impact the Company's earnings growth rate. The extent of the impact will depend in significant part on the number, timing and performance of new facilities.

Other Income and Expense Items

Interest and other income: Interest and other income was $7,064,000 in 1996, $4,497,000 in 1995, and $4,587,000 in 1994. This income is primarily attributable to interest income on cash balances (as a result of uninvested net equity offering proceeds during 1996 and 1995) and interest income from mortgage notes receivable. The Company canceled approximately $700,000 in 1996, $16,435,000 in 1995, and $24,441,000 in 1996 of mortgage notes receivable 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 $3,709,000 in 1996 from affiliated parties. As a result, interest income from mortgage notes receivable decreased from $4,333,000 in 1994 to $1,974,000 in 1995, as the average outstanding mortgage notes receivable balance was significantly lower. Interest income from the mortgage notes receivable increased from $1,974,000 in 1995 to $2,710,000 in 1996 as a result of the notes acquired in 1995 and 1996.

Management's Discussion and Analysis of Financial Condition and Results of Operations *(continued)*

Depreciation and amortization: Depreciation and amortization expense was $64,967,000 in 1996, $40,760,000 in 1995, and $28,274,000 in 1994. These increases are principally due to the acquisition of additional real estate facilities in each period combined with amortization of intangible assets acquired in connection with the PSMI Merger. Depreciation expense with respect to the real estate facilities was $55,689,000 in 1996, $39,376,000 in 1995, and $28,099,000 in 1994; the increases are due to the acquisition of additional real estate facilities in 1994 through 1996. Amortization expense with respect to intangible assets acquired in the PSMI Merger totaled $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 $5,524,000 in 1996, $3,982,000 in 1995, and $2,631,000 in 1994. 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 expected 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 $8,482,000 in 1996, $8,508,000 in 1995, and $6,893,000 in 1994. 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 decrease in interest expense in 1996 compared to 1995, principally is due to the early retirement of debt in 1996 of approximately $41.0 million having a weighted average interest rate of 7.76% partially offset by 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 Partnerships conducted independent environmental investigations of their real estate facilities. As a result of these investigations, the Company has 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 $4,983,000 in 1994 and $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 the Consolidated Partnerships 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 Partnerships. 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 Partnerships' income. However, offsetting the reduction in minority interest in 1996 caused by the acquisition of additional equity interests are the inclusion of additional partnerships in the Company's consolidated financial statements. During 1996, the Company acquired sufficient ownership interest and control in three 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 $2,187,000 in 1996.

In determining income allocable to the minority interest for 1996, 1995 and 1994 consolidated depreciation and amortization expense of approximately $11,490,000, $11,243,000 and $13,556,000, respectively, was allocated to the minority interest. The decrease in depreciation allocated to the minority interest was principally the result of the acquisition of limited partnership units in the Consolidated Partnerships by the Company throughout fiscal 1994, 1995 and 1996 offset by an increase in 1996 resulting from the above mentioned consolidation of three partnerships.

Supplemental Property Data and Trends

There are approximately 81 ownership entities owning in aggregate 1,064 self-storage facilities, including the facilities which the Company owns and/or operates. At December 31, 1996, 343 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 721 facilities are owned by the Company and Consolidated Partnerships, many of which were acquired through business combinations with affiliates during 1996, 1995, and 1994.

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 1,064 self-storage facilities (herein referred to as "Same Store" self-storage facilities) which have been operated under the "Public Storage" name for at least the past three years. The Same Store group of properties includes 613 consolidated facilities and 338 facilities owned by Unconsolidated Entities. The following table summarizes the pre-depreciation historical operating results of the Same Store self-storage facilities:

Same-Store Mini-Warehouse Facilities:
(Historical property operations)

	Year Ended December 31,			Year Ended December 31,		
(Dollar amounts in thousands, except rent per square foot)	1996	1995	Change	1995	1994	Change
Rental income	$445,586	$422,933	5.4%	$422,933	$403,295	4.9%
Cost of operations[1]	158,212	149,660	5.7%	149,660	144,752	3.4%
Net operating income	$287,374	$273,273	5.2%	$273,273	$258,543	5.7%
Gross profit margins[3]	64.5%	64.6%	(0.2)%	64.6%	64.1%	0.8%
Weighted avg. occupancy	91.2%	90.1%	1.2%	90.1%	89.2%	1.0%
Weighted avg. realized rent per sq. ft.[2]	$8.76	$8.40	4.3%	$8.40	$8.16	2.9%
Weighted avg. scheduled annual rent per sq. ft.[2]	$9.00	$8.16	10.3%	$8.16	$7.80	4.6%

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

	1996	1995	1994
Payroll expense	$ 43,490	$ 42,545	$ 41,092
Property taxes	40,799	38,325	36,941
Property management fees	26,139	25,391	24,214
Advertising	3,851	3,502	3,709
Telephone center costs	1,956	–	–
Other[4]	41,977	39,897	38,796
	$158,212	$149,660	$144,752

2. Realized rent per square foot 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 include a 6% management fee. The gross profit margin excluding the facility management fee was 70.5%, 70.6% and 70.1% in 1996, 1995 and 1994, 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. As of December 31, 1996, the national telephone reservation system was supporting rental activity at all of the self-storage properties managed by the Company, with the exception of one major market, which will be operational by end of March 1997.

Rental income for the Same Store facilities included promotional discounts totaling $6,000,000 in 1996 ($3,000,000 of which occurred during the fourth quarter of 1996) compared to $729,000 and $1,466,000 in 1995 and 1994, respectively. The significant increase in 1996 was principally due to experimentation with pricing and promotional discounts designed to increase rental activity.

In addition to evaluating property operating trends in occupancy, realized rents, expenses and net operating income on a Same Store basis, management evaluates trends by geographic regions. Operating trends for the Same-Store facilities for the five largest regions are shown in the table on the following page.

Management's Discussion and Analysis of Financial Condition and Results of Operations *(continued)*

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:														
1996	$65,222	8.61%	$79,524	4.88%	$39,704	1.31%	$27,908	3.11%	$31,123	9.00%	$202,105	5.13%	$445,586	5.35%
1995	60,053	5.77%	75,826	3.60%	39,191	2.69%	27,066	3.14%	28,552	7.67%	192,245	5.39%	422,933	4.87%
1994	56,777	4.40%	73,191	6.73%	38,163	4.32%	26,241	3.45%	26,518	12.64%	182,405	9.94%	403,295	7.73%
Cost of operations:														
1996	$18,457	3.37%	$24,580	5.72%	$16,482	5.83%	$10,772	3.46%	$14,887	5.47%	$73,034	6.69%	$158,212	5.71%
1995	17,856	3.39%	23,250	(1.62)%	15,574	1.51%	10,412	1.06%	14,115	16.94%	68,453	3.51%	149,660	3.39%
1994	17,271	5.68%	23,633	5.52%	15,342	9.35%	10,303	4.03%	12,070	0.32%	66,133	4.19%	144,752	4.76%
Net operating income:														
1996	$46,765	10.83%	$54,944	4.50%	$23,222	(1.67)%	$17,136	2.89%	$16,236	12.46%	$129,071	4.26%	$287,374	5.16%
1995	42,197	6.81%	52,576	6.09%	23,617	3.49%	16,654	4.49%	14,437	(0.08)%	123,792	6.47%	273,273	5.70%
1994	39,506	3.85%	49,558	7.39%	22,821	1.19%	15,938	3.09%	14,448	25.51%	116,272	13.51%	258,543	9.47%
Weighted avg. occupancy:														
1996	94.5%	3.73%	87.3%	2.46%	89.6%	1.36%	88.7%	0.23%	92.8%	–	92.2%	0.55%	91.2%	1.22%
1995	91.1%	3.52%	85.2%	2.40%	88.4%	–	88.5%	(1.34)%	92.8%	1.98%	91.7%	0.33%	90.1%	1.01%
1994	88.0%	0.57%	83.2%	3.35%	88.4%	1.61%	89.7%	(1.32)%	91.0%	7.44%	91.4%	2.81%	89.2%	2.53%
Weighted avg. realized rents per sq. ft.:														
1996	$10.20	4.94%	$10.32	2.38%	$6.84	–	$8.04	3.10%	$8.88	8.82%	$8.40	4.48%	$8.76	4.29%
1995	9.72	2.53%	10.08	1.20%	6.84	1.79%	7.80	4.84%	8.16	4.62%	8.04	4.69%	8.40	2.94%
1994	9.48	2.60%	9.96	3.75%	6.72	3.70%	7.44	3.33%	7.80	4.84%	7.68	6.67%	8.16	6.25%

Factors affecting regional trends in revenues and expenses include:

- acts of nature, including the Northridge earthquake (Southern California, 1994).
- new competition from property development (Texas)
- property valuations and related reassessments for purposes of property taxes (Illinois, 1995)

These factors have and are expected to continue to affect regional operating trends. During 1997, management expects additional property tax assessments due to higher valuations/rates, resulting in increased property taxes.

LIQUIDITY AND CAPITAL RESOURCES

The Company has operated and intends to continue to operate in a self-sufficient manner without reliance on external sources of financing to fund its ongoing operating needs. The Company believes that funds internally generated from ongoing operations 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.

Internally generated cash flows: The Company believes that important measures of its performance as well as its liquidity are cash provided by operations, funds from operations ("FFO") and the ability of these measures to fund the Company's operating requirements (i.e. capital improvements, principal payments on debt, and distribution requirements).

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. Net cash provided by operations has increased over the past three years from $79.2 million in 1994 to $245.2 million in 1996.

Operating as a REIT, the Company's ability to retain cash flow for reinvestment is restricted. In order for the Company to maintain its REIT status, a substantial portion of its operating cash flow must be used to make distributions to its shareholders (see *"REIT status"* below). Remaining cash flow must then be sufficient to fund necessary capital improvements and scheduled debt service requirements. 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 is available to the Company to make both scheduled and optional principal payments on debt, pay distributions to common shareholders and for reinvestment.

	For the Year Ended December 31,		
(In thousands)	1996	1995	1994
Net income	$153,549	$ 70,386	$ 42,118
Depreciation and amortization	64,967	40,760	28,274
Depreciation from Unconsolidated Entities	17,450	2,045	–
Minority interest in income	9,363	7,137	9,481
Environmental accrual	–	3,251	–
Amortization of discounts on mortgage notes receivable	(92)	(113)	(693)
Net cash provided by operating activities	245,237	123,466	79,180
Distributions from operations to minority interests	(20,853)	(18,380)	(23,037)
Cash from operations/FFO allocable to the Company's shareholders	224,384	105,086	56,143
Less: preferred stock dividends	(68,599)	(31,124)	(16,846)
Cash from operations/FFO available to common shareholders	155,785	73,962	39,297
Capital improvements to maintain facilities:			
Self-storage facilities	(15,957)	(8,509)	(6,360)
Commercial properties	(4,409)	(2,852)	(1,952)
Add back: minority interest share of capital improvements to maintain facilities	3,159	3,219	2,948
Funds available for principal payments on debt, common dividends and reinvestment	138,578	65,820	33,933
Cash distributions to common shareholders	(67,709)	(38,586)	(21,249)
Funds available for principal payments on debt and reinvestment	$ 70,869	$ 27,234	$ 12,684

See the Consolidated Statements of Cash Flows for the each of the three years in the period ended December 31, 1996 for additional information regarding the Company's investing and financing activities.

Total FFO increased to $224,384,000 for the year ended December 31, 1996 compared to $105,086,000 in 1995 and $56,143,000 in 1994. FFO available to common shareholders (after deducting preferred stock dividends) increased to $155,785,000 for the year ended December 31, 1996 compared to $73,962,000 in 1995 and $39,297,000 in 1994. 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.

The Company accounts for the Unconsolidated Entities using the equity method of accounting, and, accordingly, earnings are recognized based upon the Company's interest in each of the partnerships and REITs. This interest is based on the Company's share of the increase or decrease in the net assets of the entities from their operations. Provisions of the partnerships' and REITs' governing documents 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 all investors in current earnings. As a result, actual cash distributions paid to the Company for a period of time will be less than the Company's interest in the entities' FFO. During 1996, FFO distributed to the Company was approximately $16.4 million less than the Company's share of FFO. Preferred cash distributions paid to other investors during each period have the effect of increasing the Company's economic interest in each of the respective enti-

Management's Discussion and Analysis of Financial Condition and Results of Operations *(continued)*

ties and reducing the amount of future preference payments which must be paid to other investors before cash distributions will be shared on a pro-rata basis with respect to each investor's actual interest. The aggregate future preference payments to other investors is approximately $81.1 million and is expected to be paid over approximately 12 years, with approximately 50% of the amount being paid over the next 3.5 years.

Distributions requirements: Over the past four years, 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 1994, 1995 and 1996, the Company distributed to common shareholders approximately 54%, 52% and 44% of its FFO available to common shareholders, respectively, allowing it to retain approximately $110.8 million over this period of time after satisfying its capital improvements and preferred stock dividend requirements.

During 1996, the Company paid dividends totaling $56,472,000 to the holders of the Company's Senior Preferred Stock, $12,127,000 to the holders of the Convertible Preferred Stock, and $67,709,000 to the holders of Common Stock. Dividends with respect to the Senior Preferred Stock and the Convertible Preferred Stock include pro-rated amounts for securities issued during 1996. The Company estimates the distribution requirements for fiscal 1997 with respect to Senior Preferred Stock and the Convertible Preferred Stock to be approximately $76.8 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 1997, the Company has budgeted approximately $26.6 million for capital improvements ($22.4 million for its self-storage facilities and $4.2 million for its commercial properties). The minority interests' share of the budgeted capital improvements is approximately $3.3 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 1997 capital improvement budget is approximately $4.8 million with respect to these expenditures.

The significant increase in capital improvements in 1996 for the self-storage facilities (as reflected in the table on page 37) is due to the acquisition of new facilities in 1996 and 1995 and the aforementioned visual enhancements during 1996.

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. During 1996, the Company retired early approximately $43.2 million of mortgage debt. At December 31, 1996, the Company had total outstanding borrowings of approximately $108.4 million. See Note 8 to the Consolidated Financial Statements for approximate principal maturities of such borrowings.

The Company uses its $150.0 million of bank credit facility (all of which was unused as of March 18, 1997) 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 1997, 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 (iv) the expected growth in the operations of PSPUD in the portable self-storage business. See further discussion below with respect to each of these activities.

The Company expects to fund these transactions with internally generated retained cash flows and borrowings under its $150.0 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. With respect to the development of additional self-storage facilities, the Company expects to enter into a joint venture arrangement, see "Development Activities" below.

External financing ability: 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 Poors and Duff & Phelps.

The Company's portfolio of real estate facilities remains substantially unencumbered. At December 31, 1996, the Company had mortgage debt outstanding of $48.7 million and had consolidated real estate facilities with a book value of $1.9 billion. The Company, however, 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). Unlike many other real estate companies, the Company has elected to use preferred stock despite the fact that the coupon rates of its preferred stock exceeds current 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 requirements 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) 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.

On March 18, 1997, the Company publicly issued 4.6 million shares of common stock, raising net proceeds of approximately $126.5 million. The Company intends to use the net proceeds from this offering 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 expenditures of PSPUD.

Proposed mergers with affiliates: In December 1996, Public Storage Properties XIV, Inc. ("Properties 14") and Public Storage Properties XV, Inc. ("Properties 15") each agreed, subject to certain conditions, to merge with and into the Company. Properties 14 and Properties 15 are affiliated, publicly traded equity REITs. Each of the mergers is conditioned on approval by the respective shareholders of Properties 14 and Properties 15. However, the mergers are not conditioned on each other. The Company expects that if approved by the shareholders, the mergers would be completed in April 1997. The estimated value of the Properties 14 and Properties 15 merger is approximately $63.8 million and $58.5 million, respectively. Properties 14 and Properties 15 own 14 properties (912,000 square feet) and 19 properties (1,087,000 square feet), respectively. The Company currently owns approximately 33% and 35% of the economic interest in Properties 14 and Properties 15, respectively.

Development activities: At December 31, 1996, the Company had eleven self-storage facilities (approximately 707,000 square feet) under construction with an aggregate cost incurred to date of approximately $33.5 million and total additional estimated cost to complete of $22.5 million. The Company currently has plans to develop an additional 17 self-storage facilities (approximately 1,026,000 square feet) in various locations at an estimated cost of approximately $70.2 million. 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.

The Company has reached an agreement in principle with a joint venture partner to participate in funding the development of approximately $220 million of self-storage facilities (including the facilities currently under development by the Company). The joint venture partner would contribute about 70% of the venture's capital with the balance provided by the Company. After a period of time, the Company would have an option to acquire the other venturer's interest. There can be no assurance that a definitive agreement can be reached between the Company and the joint venturer partner. Assuming an agreement is finalized, it is expected that the joint venture would be funded in early April 1997.

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 and provides related transportation services. PSPUD currently operates a total of 12 facilities in six greater metropolitan areas in California and Texas and anticipates opening four additional facilities in these areas and in three additional areas by the end of the first quarter of 1997. PSPUD presently anticipates expanding its operations to a significant number of additional areas during the remainder of 1997 and 1998, subject to continuing evaluation of this business and the satisfaction of regulatory requirements. There can be no assurance on the level of PSPUD's expansion or profitability.

Generally, PSPUD expects to expend an amount ranging from $850,000 to $1,100,000 per facility during the first full year of operations, depending on location and pricing structure. This estimate includes approximately $550,000 of capitalized expenditures combined with estimated first year operating losses and is based on certain assumptions indicated under "Ancillary Businesses" (pages 32-33).

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. As a REIT, the Company is not taxed on that portion of its taxable income which 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.

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 1996 amounted 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
1996	$.88	$.88	$ –	$ –
1995	.88	.88	–	–
1994	.85	.85	–	–

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.

		Range	
Year	Quarter	High	Low
1995	1st	$17⅛	$13½
	2nd	17⅛	15¼
	3rd	18¾	16⅜
	4th	19¾	17⅜
1996	1st	21⅞	18⅞
	2nd	21½	19⅜
	3rd	22⅝	19⅞
	4th	31⅜	22¼

As of February 28, 1997, there were approximately 19,676 holders of record of the common stock.

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

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 Santa Anita Operating
Company and Chairman of Santa
Anita Realty Enterprises, 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.

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

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Executive Officers

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

Harvey Lenkin
President

John Reyes
Senior Vice President,
Chief Financial Officer and
Assistant Secretary

Hugh W. Horne
Senior Vice President

Marvin M. Lotz
Senior Vice President

David Goldberg
Senior Vice President and
General Counsel

A. Timothy Scott
Senior Vice President and
Tax Counsel

Obren B. Gerich
Senior Vice President and
Assistant Secretary

Sarah Hass
Vice President and Secretary

American Office Park Properties, Inc.

Ronald L. Havner, Jr.
President and
Chief Executive Officer

Mary Jayne Howard
Executive Vice President
President-Operations Group

Mary Piper-Mutz
Vice President

Lee Rippel
Vice President

Other Corporate Officers

Samuel I. Ballard
Vice President

Anthony Grillo
Vice President

Alan Grossman
Vice President

Tamara Hughes Gustavson
Vice President - Administration

Joanne A. Halliday
Vice President

Ronald L. Harden, Sr.
Vice President

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Vice President and
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Assistant Secretary

Jill L. Webster
Vice President and
Director of Taxation

Professional Services

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

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Los Angeles, California

Management Division

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President

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