

Q2 2020

SELF-STORAGE REIT REPORT

*Cushman & Wakefield
Self-Storage Advisory Group*

SELF-STORAGE REIT REPORT

Self-Storage continues to prove its resiliency through the pandemic, but REITs have not been immune to the effects that the pandemic has had on the economy. Fundamentals remained strong in the second quarter, with most operating metrics declining in Q2 2020 compared to Q2 2019. Occupancies held high. Rental income was hampered by heavy discounting on move-in rates as well as a pause on rate increases with existing tenants. Moreover, due to pandemic-related regulations in local jurisdictions, move-in and move-out activity was down compared to 2019.

The ongoing pandemic creates uncertainty around the timing and effectiveness of a vaccine. Acquisition activity was muted through the second quarter and REITs were not as aggressive in buying as they were prior to COVID-19. Despite REIT's ongoing conservative approach to acquisitions, activity in self-storage capital markets remained extremely competitive as both institutional and private capital continued to bid on deals.

RATES

There were two main drivers impacting rental rates in the current market environment. First, to keep occupancy high, REITs discounted rates on new move-ins more heavily than they were pre-COVID. Second, the pandemic caused REITs to pause or delay rate increases for existing tenants. Due to heavy discounting on new move-ins and a lack of rate increases on existing tenants, the major storage REITs were reporting a drop in rental income in Q2 2020 compared to the same period in 2019.

RENTAL INCOMES & EFFECTIVE RATES OF REITS - Q2 2020 VS. Q2 2019

RENTAL INCOME				EFFECTIVE RATE			
	2Q19	2Q20	+/-		2Q19	2Q20	+/-
PSA	\$590,082	\$579,643	-1.8%	PSA	\$17.45	\$17.10	-2.0%
EXR	\$259,670	\$255,051	-1.8%	EXR	\$16.92	\$16.58	-2.0%
CUBE	\$130,478	\$128,941	-1.2%	CUBE	\$16.91	\$16.69	-1.3%
LSI	\$120,995	\$118,896	-1.7%	LSI	\$14.48	\$14.09	-2.7%
NSA	\$81,038	\$80,141	-1.1%	NSA	\$11.94	\$11.99	0.4%

*\$ in thousands

On a positive note, most REITs resumed rate increases on existing tenants, and reported that so far, customer behavior in response to these rate increases has not changed post-COVID.

QUOTES FROM EARNINGS CALLS

“Revenue was impacted by lower move-ins, lower street rates, higher free rent, and significant curtailment of rent increases to existing customers.”

- **Andy Gregoire (Life Storage CFO)**

“While street rates and rental activity have improved significantly, it will take time for the impact of May and June’s lower achieved rates to flow through to revenue, and we do not anticipate positive same-store revenue growth in the second half of the year.”

- **Scott Stubbs (Extra Space CFO)**

“Pausing (increases) on existing tenants for any month will have a meaningful impact on in-place rents. And so as we paused throughout the second quarter, there was a cumulative impact of several months of not sending existing tenant increases. As I highlighted, not only did we not send those during the second quarter, when we resent them and are sending increases in the second half, they are at lower magnitudes, given some of the regulations and things that we’re not doing to be mindful of the environment”

- **Joe Russell (Public Storage CEO)**

“During the month of July and into early August, rate increase letters were sent to all of our customers including those remaining in our portfolio for whom we had paused the process in mid-March. We anticipate that the rent roll will be fully caught up with rate increases by the end of the quarter”

- **Christopher Marr (CubeSmart CEO)**

“This year, the lack of rent increases to existing customers during the second quarter has weighed on in-place rental rates heading into the third quarter, and we have been slightly more aggressive with lower pricing and discounting to new customers to boost occupancy”

- **Brandon Togashi (National Storage Affiliates CFO)**

OCCUPANCY AND “GHOST UNITS”

The majority of REITs were able to improve or hold occupancy at the same levels compared to the same time period last year but some of the reported occupancy numbers may be inflated by “ghost units.” These were delinquent units that would be auctioned in a normal business environment. COVID-19 and increased regulations on evictions temporarily paused this practice. For example, Extra Space reported same-store occupancy of 95.7% as of July 31, 2020. This was higher than the 94.2% occupancy that Extra Space reported for the same period in 2019, but “ghost units” accounted for 200 basis points of their 2020 occupancy number. Without the “ghost units,” occupancy as of 7/31/2020 would be 93.7%, which was a decrease versus 2019 occupancy for the same period. There was the possibility that the units could have been auctioned and re-leased during the quarter, so that the true effect on occupancy was not directly quantifiable. These “ghost units” do impact the bottom line, lowering rental income and adding to bad debt expenses. Some REITs were more aggressive at resuming these auctions and vacating delinquent units. CubeSmart’s occupancy numbers were inflated only 40 basis points by “ghost units.”

Management strategy and store location relative to local regulations factor into an operator’s ability to resume auctions on delinquent tenants.

AVERAGE OCCUPANCY FOR REITS Q2 2020 VS. Q2 2019

	OCCUPANCY		+/-
	2Q19	2Q20	
PSA	94.0%	94.2%	+20 bps
EXR	92.6%	92.8%	+20 bps
CUBE	93.0%	93.0%	0 bps
LSI	90.8%	91.0%	+20 bps
NSA	89.5%	88.1%	-140 bps

Note that “ghost units” are included in these numbers.

QUOTES FROM EARNINGS CALLS

“From an occupancy standpoint since we paused on customer lien sales, our occupancy levels have been slightly inflated by those cubes that normally would have been subject to the lien sale process. That incremental occupancy was 90 basis points at the end of June and was down to 40 basis points at the end of July. So that’s another good indicator that we’re trending back towards normal.”

- **Timothy Martin (CubeSmart CFO)**

“While our occupancy is at an all-time high, until recently we have not been allowed to initiate the auction process in several markets, which represents approximately 47% of our same-store NOI. As a result, at the end of June, approximately 150 basis points of our occupancy is from non-paying tenants due to delays in auction. By the end of July, this inflated occupancy increased to approximately 200 basis points.”

- **Joe Margolis (Extra Space CEO)**

“Our occupancy has improved through the end of July. Even without, even if we discount the auction piece of it where we can’t do the auctions, our occupancy is so much better today than we had anticipated pre-COVID for this year so we’re very pleased with that.”

- **Joe Saffire (Life Storage CEO)**

“One other thing to add is, auction activity, as I mentioned through the phases, we had paused on auction activity for a chunk of the second quarter. We are doing auctions again. We do have a few municipalities where we’re being held back. But our auction overhand is actually quite limited. It accounts for only about 20 basis points of our overall occupancy.”

- **Joe Russell (Public Storage CEO)**

“In most markets, we’re putting auctioned units, back into the rental system again...We currently estimate that unprocessed auctions, overstate occupancy, by only about 50 basis points.”

- **Tamara Fischer (National Storage Affiliates CFO)**

OPERATING RESULTS

The increase in occupancy shown by REITs in Q2 2020 was not able to offset the impact of lower rates and less rental income, leading to a drop in NOI for all of REITs that reported earnings last week. Expenses stayed the same or increased versus the same time period last year, while rental incomes dropped across the board in Q2 2020. As a result, expense ratios increased and NOIs decreased in Q2 2020 compared to Q2 2019.

REIT RESULTS - Q2 2020 VS. Q2 2019

	NOI		+/-
	2Q19	2Q20	
PSA	\$342,587	\$308,190	-10.0%
EXR	\$194,545	\$185,528	-4.6%
CUBE	\$101,824	\$97,695	-4.1%
LSI	\$81,578	\$79,554	-2.5%
NSA	\$58,907	\$58,221	-1.2%

*\$ in thousands

In earnings calls, REITs reported they are seeing improvement in operating performance compared to the beginning of the pandemic. However, until rental activity picks back up to pre-pandemic levels and rate increases resume on existing tenants, they expect to see a decline in results compared to 2019.

QUOTES FROM EARNINGS CALLS

“And now as we report second quarter results the current operating environment feels much more positive, certainly than April and May when we were seeing what we hope was the worst of the impact of storage fundamentals”

- **Timothy Martin (CubeSmart CFO)**

“Although much more is clearer today as compared to spring when we pulled our 2020 guidance, uncertainties remain and continue to make it difficult to restore reliable and precise guidance. With that said, based on what we know today with regards to the recent momentum, current market trends, and demonstrated cost control, we anticipate that the second half of 2020 will be stronger than the same period last year as it relates to adjusted funds from operations per share”

- **Joe Saffire (Life Storage CEO)**

“Our occupancy is at an all time high and prices have begun to move in the right direction. Where we can, we have resumed more normal pricing, operational practices and auctions. However, these positive trends should not obscure the macro and industry specific risks we still face. There are still uncertainties with respect to the course and length of the virus, its economic impact, and its effect on consumers and their willingness to pay for storage”

- **Joe Margolis (Extra Space CEO)**

“Overall in July, we saw continued improving operating trends”

- **Tom Boyle (Public Storage CFO)**

“What we believe is that the worst is behind us...We do believe that the third quarter could look very much like the second quarter in terms of the decline in revenue, but I will also say that we're feeling a lot better about things today. And if you assume that there are no additional shutdowns or shelter-in-place orders around the country, we do believe that the last half of 2020 FFO should come in ahead of the last half of 2019.”

- **Tamara Fischer (National Storage Affiliates CEO)**



INVESTMENT ACTIVITY

Despite the immense amount of current uncertainty in the markets, most REITs were active from an acquisition and development standpoint in the second quarter.

Q2 2020 REIT ACQUISITION & DEVELOPMENT ACTIVITY

INVESTING AND CAPITAL ACTIVITIES (Q2 2020)						
	Acquisitions	Developments	Total	NRSF Added	\$ Spend	\$/SF
PSA	6	2	8	800,000	\$111,800,000	\$140
EXR	1	1	2	153,463	\$25,444,000	\$166
CUBE	2	1	3	302,665	\$111,600,000	\$369
LSI	0	0	0	0	\$0	\$0
NSA	4	0	4	277,560	\$36,247,000	\$131
TOTAL	13	4	17	1,533,688	\$285,091,000	\$186

**Includes wholly-owned & JV Investments*

REITs reported that despite the pandemic, they were still interested in growing portfolio through acquisitions and development. Fully occupied facilities with positive cash flows continued to be the most attractive deals, while C/O and lease-up facilities were less desirable due to the increased lease-up risk and rate degradation in the market. While C/O and lease-up deals were less attractive compared to stable deals, there was still some demand for these facilities; especially in supply constrained locations or submarkets with strong demographics and long-term viability.

QUOTES FROM EARNINGS CALLS

“There is an awful lot of private capital that is looking to invest in our sector, given the strength of the cash flows in our sector, certainly, on a relative basis to a lot of other product types, storage remains a very attractive asset class. So there is an awful lot of interest, which is keeping cap rates down.”

- **Timothy Martin (CubeSmart CFO)**

“I don’t think pricing has moved for stabilized properties...If you have a stabilized self-storage asset, it’s going to attract in a good market.”

- **Scott Stubbs (Extra Space CFO)**

“We are also vigilantly pursuing acquisition opportunities and will act swiftly when we identify transactions that we believe add value to our shareholders”

- **Scott Stubbs (Extra Space CFO)**

“What we closed in Q2, we already had under contract and a couple of those assets came out of our captive pipeline. We tend to buy those at a little better cap rate...We are definitely seeing a pickup in activity. There is a lot of capital out there waiting to be deployed, wanting to take or increase their position in self-storage”

- **Tamara Fischer (National Storage Affiliated CEO)**

“We actually began to see and continue through today a bit of an elevation of return to market and/or just conversations that we had in motion prior to the pandemic, a variety of different deals that continue to be particularly attractive. So for the most part, the types of assets that are commanding normal or consistent cap rates pre-pandemic would be stabilized assets. There’s still a lot of capital on the sidelines that’s looing out for those type of investments.”

- **Joe Russell (Public Storage CEO)**

FOR MORE INFORMATION CONTACT:

MICHAEL A. MELE

Vice Chairman
+1 813 462 4220
mike.mele@cushwake.com

LUKE ELLIOTT

Executive Managing Director
+1 813 462 4212
luke.elliott@cushwake.com

CHRIS OWEN

Director, Florida Research
+1 407 541 4417
chris.owen@cushwake.com

RYAN CLEMONS

Senior Financial Analyst
+1 813 462 4218
ryan.clemons@cushwake.com

STEVEN PAUL

Financial Analyst
+1 813 462 4226
steven.paul@cushwake.com

CUSHMAN & WAKEFIELD

One Tampa City Center, Suite 3300
Tampa, Florida 33602
cushmanwakefield.com