

VALUATION & ADVISORY

Self Storage Investor Survey

Second Quarter 2018



The survey data was collected as part of an online questionnaire that was sent to key self storage market participants during a two-week period at the end of June 2018. The market participants were asked to segregate their responses by Investment Class (A, B & C). Furthermore, the data collected is corroborated by the experience and knowledge of the 20 Self Storage Industry Group team members at Cushman & Wakefield.

Cushman & Wakefield defines the Investment Classes as follows:

Self Storage Investment Classes

Class A

- Located in a Top 50 MSA
- Market has high barriers to entry (through either lack of developable land or a lengthy entitlement process)
- Generally newer facilities in good condition with state of the art amenities including climate controlled units and secured facilities with gated access
- Professional on-site and off-site management
- Minimum size of approximately 75,000 square feet
- Good location with access to attract tenants willing to pay rents in the upper percentile in the market place

Class B

- Located in a Top 100 MSA
- Market has typical barriers to entry
- Generally facilities built since 1980 in average to good condition with amenities typical for its market including secured facilities with gated access
- Full time on-site and off-site management
- Minimum size of approximately 40,000 square feet

Class C

- Either located in a smaller market or in less desirable areas of a Top 50 MSA
- Generally 1970s or 1980s vintage properties in average to below average condition
- Generally managed by the owner and may not have an on-site manager
- May or may not have typical amenities such as gated access, security cameras and/or climate controlled units
- May have secondary, less desirable locations with generally below average access and/or limited visibility

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	Class A	Class B	Class C
Going-In Capitalization Rate			
Average Low	4.97%	5.59%	6.40%
Average High	5.92%	6.81%	8.20%
Average Overall	5.42%	6.20%	7.30%

Terminal Capitalization Rate			
Average Low	5.50%	6.39%	6.80%
Average High	6.27%	7.64%	8.05%
Average Overall	5.88%	7.01%	7.42%

Discount Rate			
Average Low	7.00%	8.87%	9.25%
Average High	9.25%	10.25%	9.75%
Average Overall	8.63%	9.33%	9.45%

Average Marketing Time (months)	2.28	2.92	4.10
Average Rent Growth	3.25%	3.36%	3.31%
Average Expense Growth	2.68%	2.72%	2.85%

Source: Cushman & Wakefield Valuation & Advisory Self Storage Practice Group

Market Trends

- Capitalization rates have stabilized and could increase slightly within the next 12 months due to the increase in interest rates. Additionally, buyers continue to recognize the risk of new supply entering the market and are more conservative in their underwriting where there is a significant potential for new supply. Most market participants are anticipating a transition given the supply-side issues impacting the underlying fundamentals.
- While there are concerns about new supply and increasing cap rates, there continues to be a significant amount of capital that is still looking to be placed in the sector. Historical high returns from the self storage REITs continue to attract new market participants.

- Investor demand for Class A trophy properties remains strong. Interest in Class B and Class C portfolio continues as investors are looking to place capital, and available Class A and B+ product is limited.
- Additionally, increases in real estate taxes, particularly after a sale, are requiring owners to manage the assessment and appeal process to ensure fair and reasonable taxes. Each municipality must be researched individually, and unless a sale triggers a reassessment, it is difficult to project the future assessment. With that being said, buyers are being cautious with their modeling of their pro forma property taxes.
- Due to the influx of new supply, the REITs lowered their growth projections in 2018. While the growth forecast has been tempered, self storage REITs are still projecting returns that are amongst the strongest of all the asset types.
- REITs have shifted their focus from acquisitions to joint ventures and third party management platforms due to concerns of new supply and increasing development costs. This allows them to control a larger percentage of the market while not outright purchasing the properties.

Development Trends

- A number of cities have issued a moratorium on self storage development to curb increases in self storage development. Other cities have required onerous steps within the development process or required special use permits (most notably, New York City, which now requires a special use permit to develop within the IBZ zone).
- Due to the changing retail landscape, some developers are looking to convert existing vacant big box stores into self storage facilities.
- In some new projects, physical absorption can be fast (12 months); however, economic absorption continues to be between 24 and 36 months for most projects.
- A major topic of market industry participants continues to be new supply which is expected to crest in 2018. While there is not a single source of reliable development data, markets such as Dallas, Charlotte, Denver, and Austin are consistently discussed as being markets with a high amount of new supply in the pipeline. Markets such as Los Angeles, San Francisco, and New York are still viewed as favorable development markets due to the high barriers to entry and population density. However, because self storage remains a trade area specific business, it is difficult to quantify any large MSA as being over-supplied.

Conclusion

The first half of 2018 was fairly stable as the industry was waiting to understand the implications of the effects of the new supply. The influx of new supply may impact rental rates and occupancy rates in certain markets, however, this is widely viewed as being short term in nature. Some market participants noted a softening in the market, while others felt that there was still capital looking to enter the market. Self storage portfolios are in demand, as market participants are looking to add to their existing footprints and new investors are looking to enter the space. We expect the market to remain cautious in 2018.

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