

## The Carolinas

### The Magnolias Are In Bloom—Is Self-Storage?

BY DALE C. EISENMAN AND MICHAEL L. McCUNE

It's easy for folks in other parts of the country to sometimes overlook the Carolinas as an economic force. One might find it surprising that these states together have the same population as Illinois and half again the land area. It also might be of interest to find out where the home office of your bank is located, as some of the largest and most powerful of the national banks are located in the Carolinas. The area is growing rapidly with high-tech employers and a great lifestyle, drawing people from all over the country. The area has one of the greatest concentrations of higher learning facilities of any place in the country. In fact, in one Raleigh salon, one of the patrons was overheard saying, "Harvard was the Duke of the North." All of the attributes of these two beautiful states have caused self-storage to become abundant throughout the area. But what is the state of the market in the Carolinas? A look at the national market first may help give us a benchmark for measuring how the market in the Carolinas varies from the rest of America.

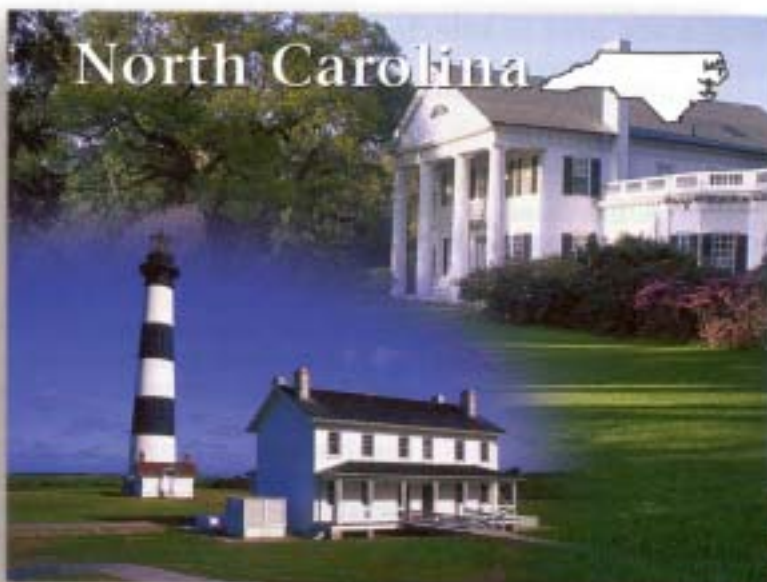
#### A Mixed Bag Of Economic Currents

The good news is first. Interest rates remain low, actually at a 40-year low, and the prognosticators seem certain that rates will stay low for the near future. In fact, some are actually projecting short-term rates to go even lower. However, the rates for medium-term fixed rate loans (seven to 10 years) probably won't go down much from this point because lenders aren't likely to risk that rates will not go up for that long of a period.

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There are rumors around of some very high quality projects getting a 6.75 percent rate.

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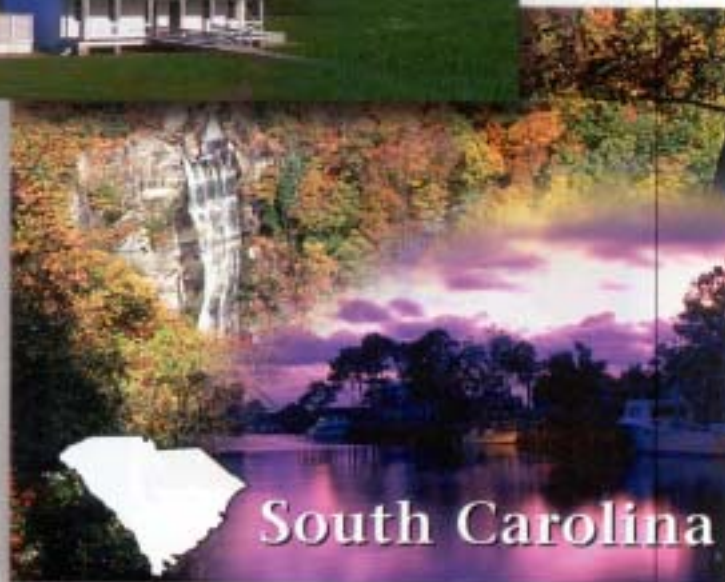


although most of the quotes for rates appear to be north of 7.25 percent. Of course, this happy circumstance also has a downside and that is the very real potential of overbuilding because there are "cheap funds" available for building new projects. The combination of low rates and money availability are just too much for a good developer

to pass up. Also, as we shall see later, the relative balance of the supply and demand in the Carolina markets may prove to be attractive to developers. However, one factor mitigating the potential is that lenders are exercising more restraint than in past economic cycles.

The national "non-recession" economy is also having an impact on the self-storage industry across the country. Hence, there is certainly a lot of anecdotal information indicating that occupancies and rates are beginning to soften. The available information would indicate that there is not a general problem, but rather a softness that appears, at least for the time being, to be highly localized.

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*Thanks to high-tech job opportunities and a great lifestyle, the Carolinas are growing rapidly. So how has this affected the region's self-storage industry?*

*Photos Courtesy of the North Carolina Division of Tourism, Film, and Sports Development and the South Carolina Office of Tourism.*

However, as we reported in the August *Mini-Storage Messenger*, the situation is becoming more generalized in the Northeast. Many operators have reported that the events of 9-11 were the turning point for slowing of demand and that

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recovery has been slow. It has been reported that one of the major national self-storage operators continued to push rates up after 9-11 and has now had to retreat to lower rental rates. Discounting, sometimes the first harbinger of lower rates, is becoming more evident in several markets.

#### The Carolinas' Future Is In The "Balance"

The first thing that we should do in understanding the Carolinas' market is to look at the sidebar provided by Chris Sonne of Self Storage Economics, who

has once again put his computer in gear and cranked out the information we need. A quick review of Chris's numbers indicate that both states are roughly in a current "state" of balance as to supply and demand. Of course, that is good

news and all would seem too well. However, these numbers may disguise some not quite so satisfying consequences for the market. While we don't have enough information to really define in detail the exact situation, we can speculate a little based on this information and at least improve our perspective. It is reasonable to assume that Chris' information shows that some local areas are not in balance, but when these areas are added together it appears that they are in balance in "total." Thus, there may be areas where there are high

to moderate vacancies and other areas where the occupancies are very high. For example, our informal survey indicates that both Raleigh, Columbia and possibly Charleston are beginning to see higher vacancies than they have recently experienced. The difficulty is that developers are attracted to areas with low vacancies and not to areas with decreased occupancies therefore causing the new development to be concentrated in a few local prosperous areas.

Let us use a very simple hypothetical situation to illustrate the impact that this could have on a local market area. Our example is a trade area of about five miles in radius with five projects of 50,000 square feet each and each with a current occupancy level of 90 percent. The market is now in equilibrium. However, assume that a developer (more on who this might be, later) decides that the Carolinas are in supply and demand balance and that this area is the best place for another project of 70,000 square feet. Apply a little math and it can be seen that this "good" market has been transformed into market that has an average occupancy of 70 percent. (The calculation is: 250,000 sq. ft. x 90% = 225,000 sq. ft. of demand, ÷ 320,000 sq. ft of supply = equals 70%.) It is clear that being one of the few areas in the country that are perceived to be in equilibrium may not be an enviable situation if developers still have cheap money. If your local trade area is selected by the developer for building, it brings new meaning to the term "lightning striking."

This situation is compounded by the fact that the Carolinas' economies are at least modestly unstable and uncertain at the moment. Several economic sectors of recent strength, textiles, fiber optics, farming, and furniture are now soft and the recovery in these sectors will likely reflect the general national recovery.

#### Look Who's Coming to Dinner

The news of the recently formed partnership of Shurgard and Morningstar indicates that Shurgard views the Carolinas as great opportunity for the future—as well it should. However, it is also clear that their stated intention is to develop more facilities. Several of our contacts have indicated that another large, very well capitalized developer and owner may have significant designs on the

Carolinas. These exceptionally large developers' building programs are more long range and they have almost an unlimited access to development funds. Thus the usual constraints on development do not apply to them.

#### Some Comments on Market Specifics

Almost all of the Carolina operators that we surveyed said that there was evidence of a slow down prior to 9-11, but that

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events in New York and Washington actually exacerbated the negative circumstances. Many operators have reduced rates since 9-11, but they have slowly begun to raise the rates again. Occupancies have not generally fully recovered and some operators feel that the slow market will persist until the direction of the economy is more clearly improving. Many of the rate reductions

were not "posted" but merely negotiated or discounted on a particular unit size. Some of the discounts were simply "move in" discounts of the "one month free variety." All of the operators said that the customers were more likely to be rental rate sensitive and were rate shopping among their competitors.

The retirement areas seemed to be holding up quite well as might be expected. However, although rental rates

did not seem to be as much of an issue, there were some large vacancies starting to appear. The operators attributed this to higher levels of affluence and that 9-11 did not impact retirees in the same way.

One large operator actually opened a new site and the project broke all rent up records for the company, proving that there are indeed still under-served pockets in the market.

#### Very Cautious Optimism

It is clear that the markets in both North and South Carolina are currently among the most stable in the nation and that the long-term prospects for these two vibrant states are very positive. Most of the problems that our survey revealed could be reasonably classified as concerned complaints rather than serious economic difficulties. However, new developers should be very wary and do a thorough feasibility study on the local trade market before considering a new self-storage project.

As one of the operators said, "The era of build it and they will come, is now over." We have also learned the near future for self-storage success in the Carolinas is largely dependent on the same factors that impact self-storage in the rest of the country—the general economy and growth. All that said, keep in mind that while the state and local economy is important, the real success of your facility is most significantly determined by what happens in your trade area. ■

#### Stay the Course

Market equilibrium is defined as a balance among the supply of self-storage and demand demonstrated in the market. This balanced market condition of equilibrium is demonstrated in the states of North Carolina and South Carolina. For example, utilizing econometric demand models, actual demand as demonstrated by existing supply in the market and indicated demand as demonstrated by demographic variables in the model are approximately equivalent.

The econometric model is based on multiple variable regression to demonstrate a relationship among demand (measured in terms of square feet per person) and four variables: population, percentage of renters, household size and average household income. The correlation or association of the data in a linear relationship (correlation coefficient) suggests these variables can be used to estimate market demand for self-storage property. Under these parameters, market equilibrium is demonstrated in both states (in terms of square feet per person) as summarized in Table 1.

Mathematically, the data suggests that supply exceeds demand slightly.

However, the variances are not considered to be statistically meaningful. For example, if demand is the exact same number as supply it would be "perfect" equilibrium. In reality, the mathematics of self-storage economics is rarely perfect. Thus, the variance in North Carolina is less than four percent (-3.55%) and more than eight percent (-8.49%) in South Carolina. Considering stabilized vacancy is generally measured at 10%, the variances in these states are not large enough to indicate over-supply.

The data suggests a cautious approach to self-storage development is warranted in these states. For example, additions to supply without population growth will saturate these markets. This underscores the wisdom that self-storage is a neighborhood business. Local neighborhood analysis is particularly important in these states that are approaching market conditions of over-supply.

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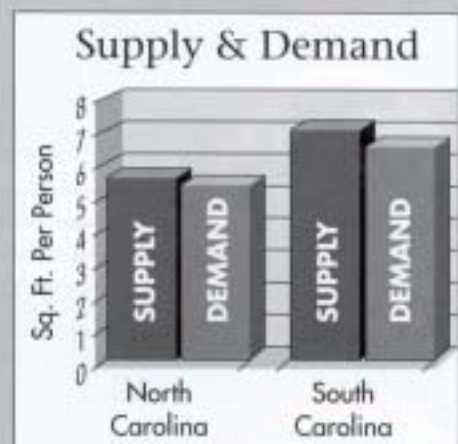


Table 1 Market Equilibrium in the Carolinas

State:	Supply	Demand	Variance	Condition
North Carolina	5.54	5.35	-0.19	Equilibrium
South Carolina	7.03	6.48	-0.55	Equilibrium