

## Arizona

### Is There A Self-Storage Cooling Trend In This Desert State?

BY R. CHRISTIAN SONNE

**W**hile the deserts of Arizona may be hot this summer, the self-storage market is in a cooling trend. The self-storage market in the state and in Phoenix is over-supplied characterized by relatively high vacancy and stable rental rates. Fortunately, the self-storage market will return to equilibrium and long-run fundamentals will remain strong, characterized by a relatively high sales velocity at stable pricing. The cure for the market is the triumvirate of successful self-storage market conditions in the Western United States: time, population growth and limited new development.

Self Storage Economics was sponsored by the Arizona Mini Storage Association (AMSA) and MiniCo to complete a market study of the Arizona self-storage market conditions. The results were initially presented at the AMSA annual conference and trade show, held at the Phoenix Airport Marriot May 1-2. A survey of 826 self-storage owners throughout Arizona was sent earlier this year, with questions regarding occupancy, rental rates (non-cooled), and current market trends. A total of 110 responses were received representing five million square feet and 52,000 units of self-storage. Key data is summarized in Table 1.



#### Self-Storage Market Conditions

In terms of self-storage supply, Phoenix and Arizona are above state and national averages. In peer group analyses of the United States by state, the *2003 Self-Storage Almanac* reports that existing supply is 7.95 square feet per person in Arizona compared to existing supply nationwide of 4.33 square feet per person. Moreover, Phoenix indicates a supply of 5.01 square feet per person compared to demand of 3.75 square feet per person. In general, the data indicates supply exceeds existing demand. However, within the state and city, there remains feasible new development searching for the undersupplied trade areas.

*While the desert is hot in Arizona, how is self-storage faring? The answers may surprise you!*

TABLE 1 Arizona Market Characteristics

Area	State	Phoenix
Average Occupancy - Units:	81.75%	79.19%
Average Occupancy - Square Feet:	84.65%	82.12%
Average Occupancy - Economic:	81.37%	79.01%
Average 5 x 5:	\$29.17	\$30.08
Average 5 x 10:	\$42.37	\$44.24
Average 10 x 10:	\$69.02	\$73.93
Average 10 x 15:	\$88.23	\$92.68
Average 10 x 20:	\$106.87	\$114.25
Average 10 x 30:	\$148.45	\$157.13

R. Christian Sonne, MAI is principal of Self Storage Economics, a data, research and analysis firm specializing in the self-storage asset class. Chris is also a member of the Appraisal Institute.



There is also a lot of good news, as the Arizona economy is relatively strong characterized by population growth of 150,000 annually, while at the same time the rate of additions to supply for self-storage are decreasing.

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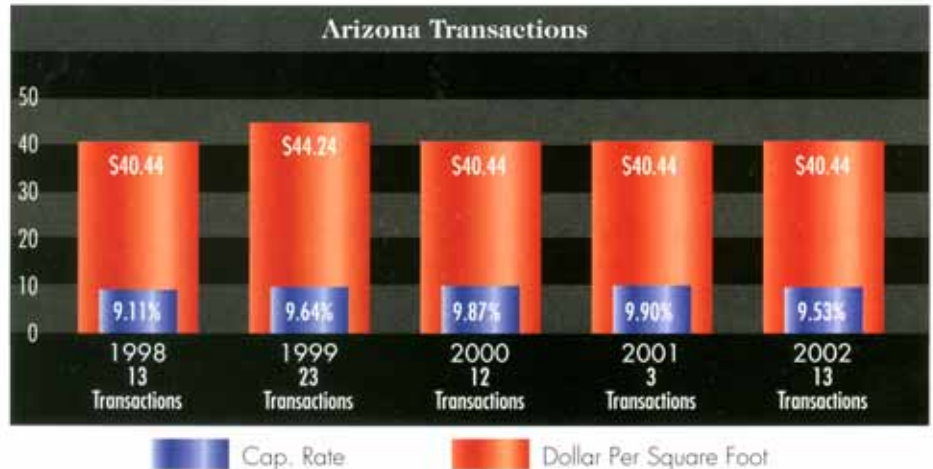
According to Kent Greenwald, a broker specializing in self-storage, 2002 additions in Phoenix representing 425,000 square feet were the lowest in 10 years. Similarly, seven facilities are proposed in 2003 totaling 460,000 square feet (*Behind Closed Doors*, Spring 2003, page 3). Statewide, total new construction is forecast at 700,000 square feet based on historical data and Phoenix trends. Based on econometric demand modeling completed by Self Storage Economics, stabilized vacancy is estimated at 10 percent and absorption is

forecast annually. Under these parameters, the return to market equilibrium is forecast at 2.75 years and 3.5 years for the Arizona and Phoenix markets, respectively, as shown in Table 2. It is important to note, that an individual trade area or local neighborhood within Arizona and Phoenix can have significantly different market characteristics.

In terms of transactions, Arizona has sold an average of one facility per month over the past five years. Robust sales

translate to investor optimism in the market fundamentals over the long run. Moreover, it demonstrates the importance of market positioning in a competitive environment. Strong projects will thrive due to a market share above fair share, while other projects will languish with vacancy higher than market averages. Because self-storage is a neighborhood specific business, market conditions may vary dramatically from one trade area to another, especially when

TABLE 2 Market Equilibrium Table		
	Arizona	Phoenix
Existing Supply	32,000,000	17,000,000
Supply Razed	—	—
New Construction	700,000	460,000
Total Supply	32,700,000	17,460,000
Less - Occupancy	(27,088,000)	(13,960,400)
Available Supply	5,612,000	3,499,600
Less Stabilized Vacancy (10%)	(3,270,000)	(1,746,000)
Indicated Over-Supply:	2,342,000	1,753,600
Annual Absorption	850,000	500,000
Equilibrium Forecast (Years)	2.76	3.51



compared to state and city data. Over the past five years, the state averages 13 transactions per year. In 2002, the average price was \$44.83 per square foot and the average overall capitalization rate was 9.53 percent.

The survey included other data queries regarding expenses, facility age, security and miscellaneous fees. Operating expenses, analyzed without real estate taxes, indicate a range in Arizona from \$0.16 to \$5 per square foot with an average of \$2.36 per square foot. In Phoenix, operating expenses (without real estate taxes) mirror the

state with an average of \$2.42 per square foot. The Prescott area indicates the highest average of \$3.20 per square foot. Operating expense data is summarized in the graph.

Annual real estate taxes averaged \$36,502 and \$37,698 per facility in Arizona and Phoenix, respectively. Taxes, based on a mill levy applied to an assessment, have reportedly been increasing in Arizona. Consequently, there is growing concern among property owners of taxes assessed above market levels.

As to refundable deposits, the survey received a very low response rate to this question (26 statewide). The range is from \$5 to \$40 with an average of \$15.83. Similarly, administration fees indicate a fairly tight range from \$1 to \$20, but the majority of respondents indicate an administration fee of \$15 (compared to an average of the data of \$10.59).

#### Summary

Data and statistics compiled by Self Storage Economics indicate self-storage

market conditions are relatively cool. Strong market and economic fundamentals, however, will strengthen the market over time with a warming trend to equilibrium. Market conditions continue to sustain a trend of industry consolidation, corroborated by stable transaction velocity statewide. Moreover, as the pace of new construction decreases, population continues to increase. Therefore, industry trends lead to stronger market conditions for self-storage.

In competitive market conditions, separating the winners from the losers becomes increasingly important. Prudent management is assessing inventory, looking for ways to improve cash flow (refinancing, reducing operating expenses) while also investing in the future by upgrading facilities as needed in the local trade area. Proactive management, maintenance and cash flow are key to enhancing competitive position of a facility above fair share. Feasible new development must be based on site specific market research. Over the long run, these trends are positive for self-storage in Arizona. 