



Self-Storage Trends

SELF-STORAGE Investor Survey Winter 2004

BY R. CHRISTIAN SONNE

This month's Self-Storage Trends highlights investment criteria for self-storage property based on the Winter 2004 Investor Survey completed by Self Storage Economics. Respondents include self-storage investors, developers, managers, brokers, and bankers from throughout the United States. The data is a summary of the survey with key information relating to general market conditions for self-storage, capitalization rates, financing, optimism index, and other current relevant information for the asset class.

The Results

A significant decline in overall capitalization rates and new information regarding IRR (internal rate of return) and equity yield for self-storage property highlight the response of the Winter 2004 Investor Survey.

As to cap rates, respondents are increasingly bifurcating rates dependent upon an analysis of trailing income or stable forecast. Approximately one-third of those responding utilize a trailing income forecast with an average cap rate of 8.30 percent. Conversely, nearly two-thirds utilize a stable forecast or proforma based on current rents, stabilized occupancy, and current expenses. The stabilized cap rate indicates an average of 9.65 percent.

Although yield capitalization or discounted cash flow analysis is not often utilized as a primary tool of valuation (less than 20 percent of respondents), the IRR range of nine to 12 percent was indicated with an average target IRR of 11.25 percent for self-storage. Moreover, an equity yield or forecast return on

equity investment (accounting for dividend and appreciation) is in the range of 15 to 25 percent with an average of 18.67 percent.

While investor optimism is steady for the self-storage asset class (a slight rise to 6.90 on a scale of one to 10), the decline in overall capitalization rates is a function of continued demand by investors that has resulted in an increase in pricing. Market activity is also fueled by capital, as respondents described financing as being widely available at "low" rates. One broker respondent is advising clients to sell now if they are considering a potential asset sale in the next several years. For example, the survey data indicates that 47 percent of the respondents believe a sell strategy is best.

This pricing trend is corroborated by a decline of 1.06 months to an average marketing time of 2.89 months for self-storage. Even forecast profit as a return on cost has increased to 17.10 percent, which is a 2.76 percent increase.

Investors remain cautious, however, continuing to express concern about

over-building, particularly by market participants new to the industry. More than half (54 percent) of the respondents said over-supply or market saturation is the biggest concern of market conditions.

In terms of trade area and demand, the data remains relatively stable with a typical trade area described as a 2.8-mile ring and a demand of 5.27 square feet per person, an increase of 8.21 percent over last year. The data, with a comparison to last year, is summarized in the table to the right.

It is important to note that like the demarcation of a trade area for self-storage, market conditions are neighborhood specific and can vary dramatically. In this regard, self-storage is an emerging asset with characteristics unique to real estate. Consequently, a local analysis is critical to determining the success of a project.

The mixed results of the survey suggest that investors remain upbeat about the self-storage asset class, albeit with concerns of over-building. Superior returns that have attracted new players to the industry are beginning to moderate suggesting stabilization over the long run. In the near term, market participants remain bullish on self-storage. ■

R. Christian Sonne, MAI, is principal of Self Storage Economics, a full-service real estate consulting company specializing in the self-storage asset class. He is also a member of the Appraisal Institute.

Self Storage Economics: Definitions

Trade Area – The geographic area immediately adjacent to the subject property from which it draws its customers. For self-storage, this is typically defined in rings of one, three, or five miles (diameter) or a polygon or irregular shape.

Per Capita Saturation – The 2004 *Self-Storage Almanac* reports 4.54 square feet of self-storage per capita or per person in the United States (in a range from less than 3.0 to more than 7.0). Investors can forecast the depth of demand in terms of square feet per person as a tool of analysis. These expectations or estimates can be more important than existing measures of supply.

Overall Capitalization Rate – Initial rate of return in an all-cash transaction.

Discount Rate (IRR) – Internal rate of return in an all-cash transaction, based on annual year-end compounding.

Trailing Income – The net operating income over a historical period such as three months or one year.

Stabilized Proforma – A current forecast of market rents and expenses at a stabilized occupancy.

Absorption Time – Once a project is complete and empty, how long does it take to stabilize occupancy and income?

Marketing Time – The period of time between the initial offering of a property for sale and the closing date of the sale.

Profit – Entrepreneurial or developer's profit is a market derived figure that reflects the amount a developer expects to receive for his or her contribution to a project. For self-storage, it is often calculated as a percentage of hard and soft costs without land contribution.

Equilibrium – The market is characterized as a balance between supply and demand.

Over-Supply – The market is over-supplied with product (saturation) resulting in vacancy and flat to declining rental rates.

Under-Supply – The market is under-supplied with product (demand exceeds existing supply) resulting in low vacancy and rising rental rates.

Note: Various sources for definitions include The Dictionary of Real Estate, Third Edition published by The Appraisal Institute; International Council of Shopping Centers; Korpacz Investor Survey; Self Storage Economics, and investor interviews.

Table 1 Self Storage Key Indicators

| Trade Area | Winter 2004 | Winter 2003 |
|--------------------------------|-----------------------|-----------------------|
| Range | 1.00 - 5.00 mile ring | 1.50 - 5.00 mile ring |
| Mode | 1.50 mile | 1.50 mile |
| Average | 2.80 | 2.82 |
| Change | -0.71 % | - |
| Demand (SF per Person) | | |
| Range | 2.00 - 12.00 | 2.00 - 8.00 |
| Mode | 4.00 | 4.00 |
| Average | 5.27 | 4.87 |
| Change | 8.21 % | - |
| Capitalization Rate | | |
| Range | 7.50 % - 11.00 % | 8.25 % - 11.00 % |
| Mode | 9.00 % | 9.50 % |
| Average | 9.19 % | 9.52 % |
| Change | -33 Basis Points | - |
| Absorption Time | | |
| Range | 18 - 40 Months | 18 - 36 Months |
| Mode | 24 Months | 24 Months |
| Average | 24 Months | 23 Months |
| Change | +1 Month | +1 Month |
| Marketing Time | | |
| Range | 1 - 6 Months | 1 - 12 Months |
| Mode | 1 Month | 1 Month |
| Average | 2.89 Months | 3.95 Months |
| Change | -1.06 Months | +0.92 Months |
| Profit (on cost only) | | |
| Range | 8.00 % - 25.00 % | 8.00 % - 30.00 % |
| Mode | 20.00 % | 20.00 % |
| Average | 17.10 % | 14.34 % |
| Change | 2.76 % | -3.34 % |
| Optimism Index (1 - 10) | | |
| Range | 5.00 - 10.00 | 5.00 - 10.00 |
| Mode | 7.00 | 7.00 |
| Average | 6.90 | 6.83 |
| Change | 1.02 % | -13.21 % |
| Market Conditions | | |
| Under-Supplied | 3.00 % | 6.00 % |
| Over-Supplied | 54.00 % | 47.00 % |
| Equilibrium | 40.00 % | 47.00 % |
| Strategy | | |
| Buy | 27.00 % | 28.00 % |
| Sell | 46.00 % | 26.00 % |
| Build | 27.00 % | 30.00 % |