



self-storage trends

Winter 2005 Investor Survey

Investors Remain Bullish On Self-Storage

By R. Christian Sonne, MAI

Led by declines in the expectations of overall capitalization rates, investors remain bullish on the self-storage asset class. The average overall capitalization rate declined to 8.28 percent nationwide, a significant decline of 91 basis points from last year or -9.90 percent as seen in the Cap Rate Trends graph.

The Winter 2005 *Investor Survey* was completed by Self Storage Economics through primary survey research (interview and Internet responses) of over 50 market players representing more than 100 million square feet of self-storage property nationwide. Respondents are primarily involved in the self-storage asset class and include investors, developers, managers, owners, brokers, and bankers. The complete data is summarized in the Key Indicators table.

Survey Results

Investors also indicate a decline in the Internal Rate of Return or IRR (yield capitalization) to 11 percent, a decline of 25 basis points (2.22 percent) from last year. The IRRs were reported in a range from 9.0 percent to 12 percent, and only 30 percent of the respondents reported that the IRR is used as a tool of analysis for self-storage property. The forecast of demand per person for self-storage property increased to 5.36, a slight increase of 1.71 percent over last year. These market expectations of demand track closely with actual demand as reported in the *2005 Self-Storage Almanac* (4.94 square feet per person nationwide). Moreover, respondents indicate they do use this technique (square feet

of self-storage per person) as a primary tool when making investment decisions.

Other positive indicators include an increase in the estimate of profit as a percentage of building cost. The survey indicates 20.14 percent profit factor is forecast, an increase of nearly 18 percent from the profit factor of 17.10 percent from 2004. Similarly, the forecast average trade area increased to a 3.3-mile ring (diameter), up from 2.8-miles last year (however, the most typical response or mode was a trade area of a 3.0-mile ring).

Despite all these positive indicators, there is a growing contrarian trend. For example, the *Investor Survey* indicates the single greatest concern of market players is over-building, particularly from new market players who are less experienced in the self-storage asset class. One remarkable response came from a developer who complained that financing was easy and "too available." In 20 years of real estate analysis, I have never before heard a developer complain that the cost of capital was easy! A regional investor in the west said inexperienced developers are building "ill-conceived" properties. One banker cautioned against some "irrational exuberance" in the self-storage asset class, but emphasized it varies widely per market.

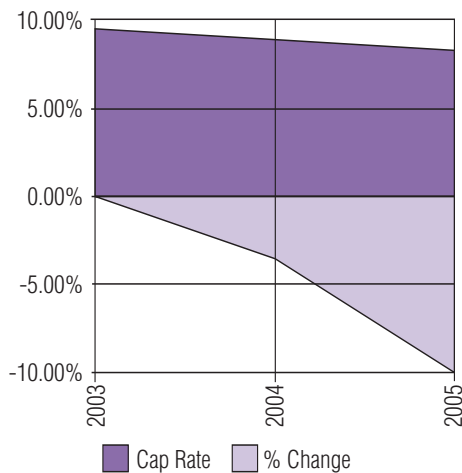
One property owner said too many investors were chasing the positive returns self-storage has historically offered, but in markets that are now over-supplied. Half the respondents described market conditions for self-storage as over-supplied. Similarly, 60 percent of the respondents said the best strategy now is to sell. To illustrate the rise in this trend to sell, the self-storage strategy chart demonstrates the dramatic rise in the sell response: from 26 percent in 2003 to 60 percent in 2005. Perhaps the most telling indicator is the Optimism Index. It indicates an average of 6.65, a decline from 6.9 last year.

Participants in the survey also indicate a rise in marketing and absorption time. As to marketing time (the time it takes to sell a property listed for sale), the average increased slightly to 3.06 months. The forecast or expectation of absorption time of a project (once complete, the time to stabilize occupancy and income) increased from 24 months to 27 months. This represents a change of +12.50 percent.

The "B" Word?

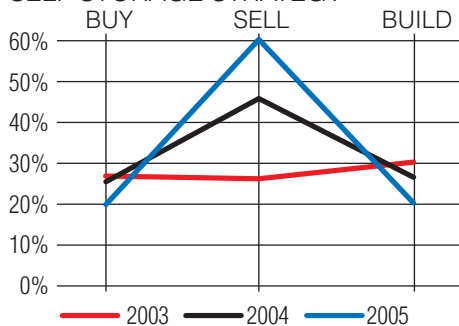
The data is interesting, but the story the data tells is even more compelling. How

CAP RATE TRENDS



Source: Self Storage Economics

SELF STORAGE STRATEGY



Source: Self Storage Economics

can capitalization rates decline while investor fears rise? This is a foreshadowing of the concerns of the future. Market conditions are the best ever for the self-storage asset class with financing widely available at relatively low rates, while investor interest is at an all time high. Consequently, one nationwide broker mentioned the possibility of the "B" word for the industry. A bubble or the "B" word is a mass-psychological phenomenon. It occurs when the herd follows the trend and continues to invest with the expectations of a bull without regard to the possibility of a bear.

Real estate economists are always wary of predicting the date or time of changing market conditions. Therefore, noting the concerns of the market is good for self-storage market conditions over the long run. The current upward momentum in self-storage has exceeded even the high tide of commercial-industrial real estate. Yet, wise investors

2005 SELF-STORAGE INVESTOR SURVEY: KEY INDICATORS

Time	Winter 2005	Winter 2004	Winter 2003
Trade Area			
Range	1.00 - 5.00	1.00 - 5.00	1.50 - 5.00
Mode	3	1.5	1.5
Average	3.3	2.8	2.82
Change	17.86%	-0.71%	--
Demand (Square Foot Per Person)			
Range	3 - 12	2 - 12	2 - 8
Mode	5	4	4
Average	5.36	5.27	4.87
Change	1.71%	8.21%	--
Capitalization Rate			
Range	7% - 10%	7.50% - 11.0%	8.25% - 11.00%
Mode	8.50%	9.00%	9.50%
Average	8.28%	9.19%	9.52%
Change	-91 Basis Points	-33 Basis Points	--
Absorption Time			
Range	12 - 44 Months	18 - 40 Months	18 - 36 Months
Mode	24 Months	24 Months	24 Months
Average	27 Months	24 Months	23 Months
Change	+3 Months	+1 Month	--
Marketing Time			
Range	1 - 12 Months	1 - 6 Months	1 - 12 Months
Mode	1 Month	1 Month	1 Month
Average	3.06 Months	2.89 Months	3.95 Months
Change	+0.17 Month	-1.06 Months	--
Profit (on cost only)			
Range	10.00% - 30.00%	8.00% - 25.00%	8.00% - 30.00%
Mode	20.00%	20.00%	20.00%
Average	20.14%	17.10%	14.34%
Change	17.78%	19.25%	--
Optimism Index (1 -10)			
Range	3.00 - 9.00	5.00 - 10.00	5.00 - 10.00
Mode	6.50	7.00	7.00
Average	6.65	6.9	6.83
Change	-3.62%	1.02%	--
Market Conditions			
Under-Supplied	15%	3%	6%
Over-Supplied	50%	54%	47%
Equilibrium	35%	40%	47%
Strategy			
Buy	20%	27%	28%
Sell	60%	46%	26%
Build	20%	27%	30%

Source: Self Storage Economics

continue to express caution in view of these conditions.

These expressions outlined in the data of the Investor Survey underscore the importance of careful market research. It is insufficient to measure the past trends based on historical data. In this regard, an in-depth investor survey looks to the future by measuring the expectations of market players. Self-storage is a neighborhood specific asset with wide

variances of market conditions even within a particular city or metropolitan statistical area (MSA). Therefore, local research remains the most important tool to investors. ■

R. Christian Sonne, MAI is President of Huntington Beach, California-based Self Storage Economics, a full-service real estate consulting company specializing in appraisal and market study of the self-storage asset class.