

# BUSINESS BRIEFING

## SELF STORAGE

# RECESSION RESISTANT

IT MAY NOT BE EXACTLY RECESSION PROOF,  
BUT SELF STORAGE REAL ESTATE IS STAYING AFLOAT

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## EXECUTIVE SUMMARY

Is self storage recession proof? The asset class is defined by steady cash flows, a low break-even point and minimal capital expenditures. But, in an economic recession and capital markets depression, investors and owners are increasingly concerned about the impact of the current environment on self storage property.

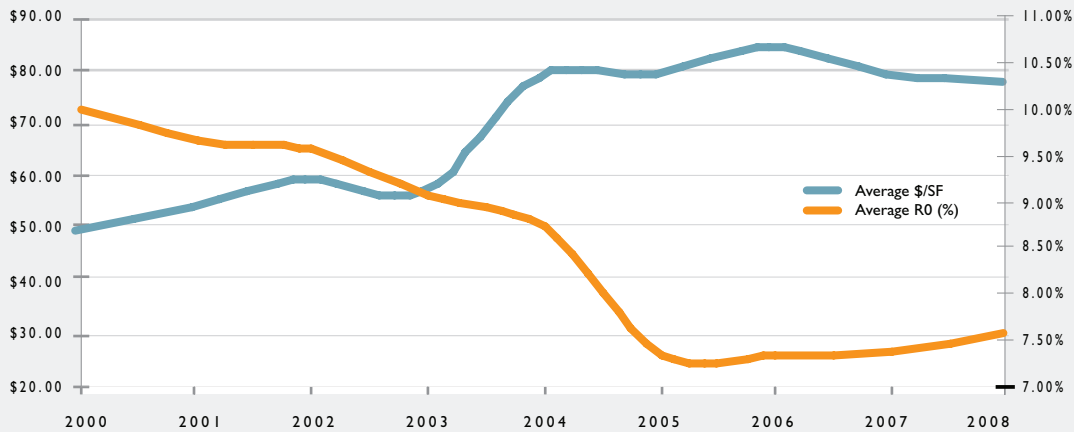
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## CAPITAL MARKETS IMPACT

In the current economy, the recession is also a function of the capital markets. As the cost of capital has increased while availability has decreased, the economy has suffered. Like all real estate, self storage rose with all ships when the capital markets tide came in. As shown in the National Self Storage Trends graph, values increased as overall capitalization rates decreased. Overall capitalization rates declined as a function of the capital markets – money was easy and cheap.



NATIONAL SELF STORAGE TRENDS



Sources: CoStar Group, Inc., Self Storage Industry Group at C&W

As the capital markets froze, overall capitalization rates began rising at a pace of about 8 basis points per month based on survey research. At the end of last year, an average overall cap rate for a typical self storage facility was about 8.0%. Six months later, the average rate was 8.50%. Cap rates vary by class, so urban Class A facilities may be as much as 100 bps lower. Conversely, rural Class C facilities may be as much as 100 bps higher than the national average. Sales data corroborates the trend, but with a time lag because of the length of time to market and close a sale (the motivations and expectations of buyers and sellers vary during this period of time).

Consequent to the trend of rising overall capitalization rates, self storage values are declining. Yet, net operating income increased at a compound annual rate of 2.02% during the time frame of the National Self Storage Trends graph. It is also important to note that the last decade has seen unprecedented growth of new self storage facilities, yet cash flow continued to increase. This suggests that the condition of the capital markets impacts self storage values, but not cash flow.

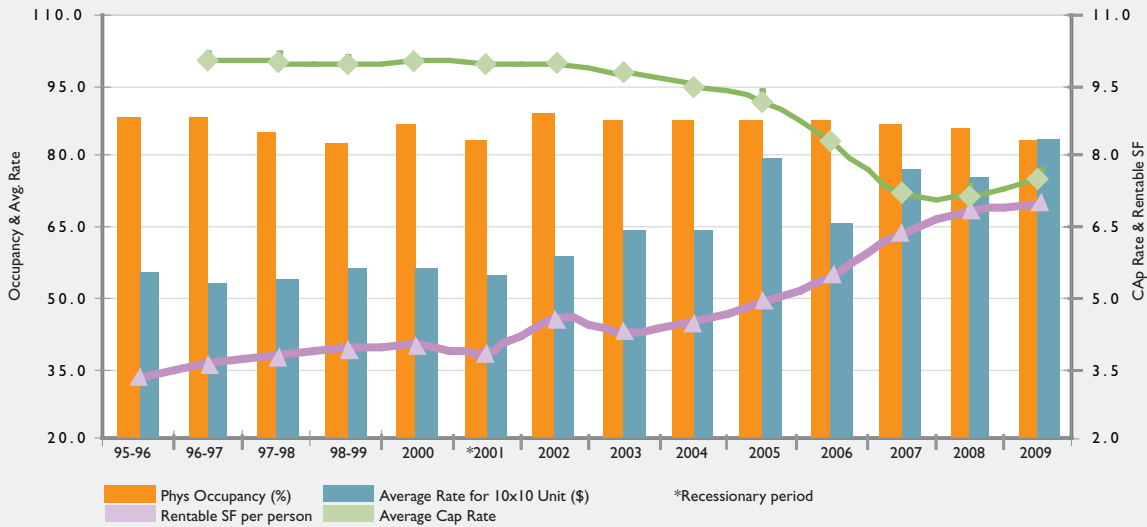
### RECESSION IMPACT

As to the recession, opinions are mixed about the impact to self storage. Some have expressed concern that with declining household budgets, demand for storage property will decrease. Others think that increasing foreclosures in housing and moving caused by economic conditions may increase demand. Anecdotally, many veteran market players have long expressed the view that self storage was recession resistant. One national brokerage firm recently had a team of 20 brokers survey ten operators each (for a sample size of approximately 200). In general, most estimated that cash flow had decreased -5% or less due to the recession.

To test the impact of the recession on self storage, the Self Storage Industry Group at Cushman & Wakefield developed a time series, scoring model. The score is the sum of the national average of occupancy and income (income is expressed as the average rate for a 10 x 10 unit). Data was derived from The Self Storage Almanac. The 17-year time series begins in 1991 and extends to 2008. The analysis is presented in the graph as follows:



SELF STORAGE TIME SERIES



Sources: Self Storage Almanac, Self Storage Industry Group at C&W

Compared to other asset classes of real estate, self storage is staying afloat even as the tide goes out with dangerous rip currents.

The data shows that during the recessionary period of 2001, the self storage score declined 3.51%. However, by 2002, it went up 6.76%. To compare, in 2008 the score declined -1.49%. As the economy remains in recession, it suggests an additional decline in 2009 of approximately -2%. Cumulatively, the data suggests that self storage is recession resistant, but not recession proof. Compared to other real estate asset classes, self storage might be described as the winner among the losers.

It is interesting to note that the 2001 score of 138.80 compared to a 2008 score of 161.84 is an increase of 16.60%. Occupancy in 2001 was 83.7% compared to 86.30% in 2008, not much of a variance for survey research. Income, however, rose an astonishing 37.10% during the same period rising from a national average rate for a 10 x 10 unit of \$55.10 per month in 2001 to \$75.54 per month in 2008. Rate increases actually exceeded inflation during a building boom!

### THE BOTTOM LINE

The quantitative analysis of the data supports the qualitative conclusions of industry veterans: self storage is NOT recession proof, but it is recession resistant. Compared to other asset classes of real estate, self storage is staying afloat even as the tide goes out with dangerous rip currents.

Self storage is unique among real estate because demand is a function of the local trade area, generally within a three-mile radius. Unlike retail, there is no anchor tenant to induce demand. Unlike office, there are no tenant improvements to entice tenants. However, these are also positive characteristics. For example, credit risk is spread among hundreds of tenants and tenant improvements upon renewal are typically a function of sweeping out the unit. As a result, self storage cash flow is typically durable.



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The challenge to the asset class is for properties in over-supplied trade areas. Because demand is difficult to induce (only by rates and concessions), the only cure is population growth and time. Facilities in chronically over-served trade areas can languish at 65% occupancy for years. On a positive note, anecdotal evidence suggests new construction is at the lowest point in a decade and demographers are forecasting population growth of nearly 100 million over the next two generations. These socio-economic factors suggest stability and growth to the asset class over the long run.

## ANSWER THE QUESTION

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Based on the analyses, self storage is resistant to economic recession as measured by occupancy and income. As most expenses are fixed, cash flow is likely to remain relatively stable. Caution is warranted for facilities that are in the absorption phase with construction loans coming due. With de-leveraging, it is likely some owners will be forced to sell at a loss due to a capital call by lenders.

Ultimately, self storage market conditions remain fundamentally stable, even during the economic recession and capital markets depression. Cash flows are forecast to decline another two percent this year, but during recovery will likely increase at a pace that exceeds inflation. Values will decline as overall capitalization rates rise, but cash flows will remain resilient.



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