

BUSINESS BRIEFING

SELF STORAGE INVESTOR SURVEY

SELF STORAGE DELIVERS

ANNUAL SURVEY HIGHLIGHTS THE GROWING STRENGTH OF THIS REAL ESTATE ASSET CLASS

OCTOBER 2007 | A CAPITAL MARKETS VALUATION PUBLICATION

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EXECUTIVE SUMMARY

The 2007 Self Storage Investor Survey polled over 50 market players representing more than 100 million square feet of self storage property. Results reveal that respondents believe the self storage real estate market remains a core real estate asset, yielding high return and low loss.

Stabilization is a new factor in self storage investment after a five-year downward trend. However, despite uncertainty in the marketplace fueled by concern about interest rates, the asset class remains strong, thanks to a bullish outlook in the industry over all.

2007 SELF STORAGE INVESTOR SURVEY

A cautious game plan is the approach in the 2007 Self Storage Investor Survey as players are watching the game from the sidelines, waiting for the capital fluctuations to stabilize. Consequently, overall capitalization rates remain stable at 7.19 percent nationwide, an insignificant variance of seven basis points from one year ago. Nevertheless, self storage remains a winner in terms of comparatively high returns accompanied by low loan loss ratios. As many investors are focusing on defensive play, the self storage market has stabilized.

Stabilization is a new play to self storage after a five-year downward trend in overall capitalization rates. The 2002 survey indicated an average overall capitalization rate of 9.52 percent nationwide, declining to 7.19 percent five years later, an incredible drop of 233 basis points (24.47 percent). Investors' greatest concerns are now related to financing and the cost of capital, as higher interest rates will cause capitalization rates to rise and values to fall. High leveraged owners are concerned about a double negative to cash flow: increasing interest rates and declining values.

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The 2007 survey was completed by the Self Storage Industry Group of Cushman & Wakefield 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 and lending fiduciaries. The results, and five-year trend, are summarized in the key indicators table below.

2007 SELF STORAGE INVESTOR SURVEY: KEY INDICATORS

	2007	2006	2005	2004	2003
Trade area					
Range:	2 - 5	1 - 60	1 - 5	1 - 5	1.5 - 5
Mode:	3	3	3	1.5	1.5
Average:	3.33	3.14	3.3	2.8	2.82
Change:	6.05%	- 4.85%	17.86%	- 0.71%	-
Demand (sq. ft. per person)					
Range:	3 - 10	2 - 10	3 - 12	2 - 12	2 - 8
Mode:	6	5	5	4	4
Average:	6.12	5.7	5.36	5.27	4.87
Change:	7.37%	6.34%	1.71%	8.21%	-
Capitalization rate					
Range:	6% - 9%	6% - 9%	7% - 10%	7.5 - 11%	8.25% - 11%
Mode:	7.25%	7%	8.5%	9%	9.5%
Average:	7.19%	7.26%	8.28%	9.19%	9.52%
Change:	- 7 basis points	- 102 basis points	- 91 basis points	- 33 basis points	-
Absorption time (months)					
Range:	18 - 36	18 - 43	12 - 44	18 - 40	18 - 36
Mode:	30	30	24	24	24
Average:	32	30	27	24	23
Change:	+2	+3	+3	+1	-
Marketing time (months)					
Range:	1 - 12	1 - 6	1 - 12	1 - 6	1 - 12
Mode:	4	4	1	1	1
Average:	3.66	3.14	3.06	2.89	3.95
Change:	+0.52	+0.08	+0.17	- 1.06	-
Profit (on cost only)					
Range:	10% - 25%	15% - 25%	10% - 30%	8% - 25%	8 - 30%
Mode:	18%	20%	20%	20%	20%
Average:	17.63%	20.13%	20.14%	17.10%	14.34%
Change:	-12.42%	-	17.78%	19.25%	-
Optimism index (1 - 10)					
Range:	3 - 9	3 - 10	3 - 9	5 - 10	5 - 10
Mode:	6	7	6.5	7	7
Average:	6.25	6.5	6.65	6.9	6.83
Change:	- 3.85%	- 2.26%	- 3.62%	1.02%	-
Market conditions					
Undersupplied	6%	15%	15%	3%	6%
Oversupplied	52%	50%	50%	54%	47%
Equilibrium	42%	35%	35%	40%	47%
Strategy					
Buy	15%	18%	20%	27%	28%
Sell	60%	50%	60%	46%	26%
Build	25%	32%	20%	27%	30%



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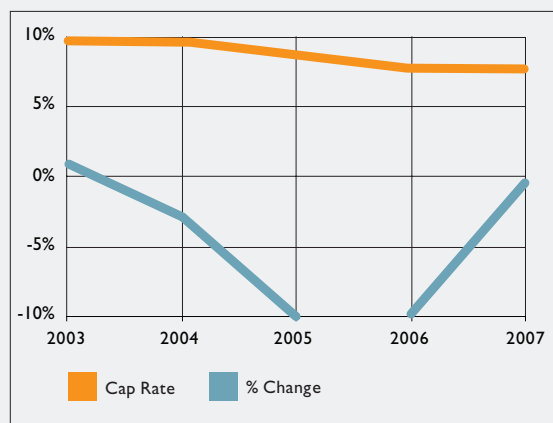
SWIMMING NAKED?

Uncertainty was exacerbated this summer by concerns raised by rating agencies of relaxed underwriting standards in the CMBS market (in addition to losses in 2007 of sub-prime residential loans). These concerns led to as much as \$50 billion of unsold loans through Wall Street conduits. As Warren Buffet said, “It’s only when the tide goes out that you can see who’s swimming naked” (*The Economist*, January 14, 2006).

Fortunately, the strength of the asset class is a strong operating history characterized by relatively high returns and low losses. Consequently, capital will continue to flow to self storage from Wall Street conduits to Main Street banks as well as life insurance companies and other private lenders. Investors who are relatively new players to the self storage game, such as Simply Self Storage, remain bullish on the asset class and have purchased over 200 facilities in the last few years. Other private equity firms are preparing IPOs for potential new self storage REITs. Investor interest, both public and private, continues for self storage. Pricing the risk of debt, given the events of the 2007 market, will likely rise. Moreover, due diligence is already increasing, led by pressure from underwriting agencies and B piece buyers. In the past, bank regulators have expressed concerns of real estate loans to Main Street banks and increased due diligence. Now, the market is responding faster than the federal regulators are. Even though the Federal Reserve has not increased the federal lending rate, the market has increased the cost or price of debt, resulting in higher interest rates in response to concerns about due diligence and to entice buyers of the loans.

Clients of appraisal services are returning to quality. It is becoming less about turn times and cheap fees and more about the ability to analyze markets carefully and thoroughly. In this regard, our proprietary econometric model is now being utilized throughout the United States and in Canada. This model analyzes existing supply, but also forecasts demand based on demographic data. These tools of analysis have fueled a significant increase in our business and market share in 2007, a result of market concerns about due diligence.

CAP RATE TRENDS



CAP RATE TRENDS

While discounted cash flow use as a tool of analysis is increasing for the self storage asset class, approximately 75 percent of our respondents rely on direct capitalization. This is because self storage has no “below the line” or non-operating expenses, so net operating income and cash flow are virtually the same. There are no tenant improvement costs nor leasing commissions. Reserves and capital expenditures tend to be paid in the repairs and maintenance category of operating expenses over time. Cap rate trends are summarized in the chart opposite.

The Internal Rate of Return (IRR or yield capitalization) hovered around 10 percent using a ten-year model (unleveraged). Capitalization rates represent a stable scenario, or forecast, going forward twelve months of net



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operating income. The most dramatic shift in trends is the percentage change in overall capitalization rates. Due to the rising cost of capital, the rate of change was literally off the chart in 2006; now the trend line shows an increasing forecast into the future. Depending on interest rates, overall capitalization rates may rise as much as 25 basis points over the next year.

Loans remain widely available for the self storage asset class, and the survey indicates a typical loan in the 6 to 7 percent range with a ten-year term, 25-year amortization, a 75 percent loan to value ratio and a 1.2 debt coverage ratio as typical parameters. However, most surveyed believe interest rates will continue to rise throughout 2007 and debt coverage ratios will climb. The impact of interest rates on overall capitalization rates is illustrated in the simple band of investment chart below. Parameters include a 75 percent loan to value at a 6.5 percent interest rate amortized over 25 years.

For purposes of analysis, the return to equity will be based on 4 percent. The analysis is summarized as follows:

SIMPLE BAND OF INVESTMENT		
Component	Ratio	Ratio
Mortgage:	.75	x .0810 = .0608
Equity	.25	x .0400 = .0100
Ro	100 percent	100 percent

A 50-basis-point increase in the interest rate results in an overall capitalization rate of 7.38 percent if the return to equity remains the same. On \$100,000 of net operating income, this results in approximately a 5 percent decline in value. However, equity returns often rise with capital increases, as risk is a concern to all parties and because of the concomitant herd mentality of investors. Additionally, leverage ratios may decline and debt coverage ratios increase, causing further downward pressure on asset pricing.

Most respondents continue to describe market conditions as “over-supplied” and the optimism index declined slightly to 6.25 (on a scale from 1 lowest to 10 highest). The decline in optimism is a slide of nearly 10 percent from the peak optimism expressed in 2004. Similarly, the average absorption time increased by two months to an average of 32 months after completion of construction to stabilized occupancy and income. Marketing time or the time to sell a property increased to 3.66 months.

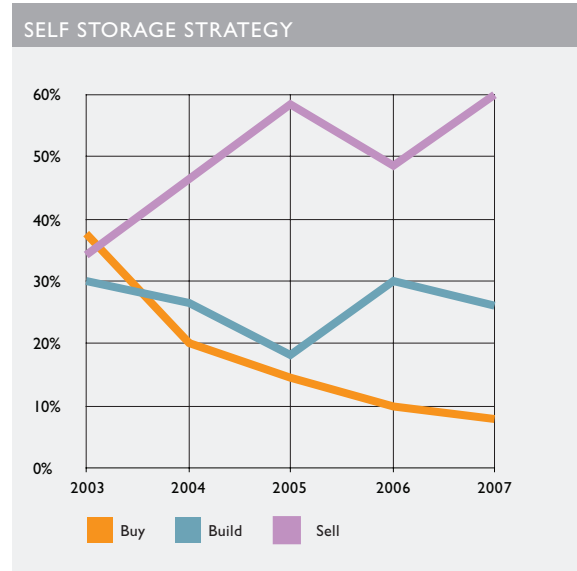
Cumulatively, the data reflects concerns of over-building and uncertainty about interest rates. In this regard, it is important to remember that self storage remains a local or neighborhood business. What happens in the local trade area is more important than national, regional or core based statistical area trends. Investors estimate an average trade area of 3.34 mile radius or a slight increase over last year.

Demand for self storage property, measured in terms of rentable square feet per person, increased to an average of 6.12 square feet per person. This reflects an increase from 5.7 in 2005, a change of plus 7.37 percent. Comparatively, the 2007 Self-Storage Almanac reports there are nearly 43,000 facilities nationwide that represent 6.4 square feet per person.



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In terms of strategy, selling is at an unprecedented high. Investors expressed concerns about rising interest rates and lower cash flow. Additionally, some felt that values have been at an all-time high and are likely to decline in many areas. However, sellers are reluctant to sell for lack of better, alternative investments. Brokers indicate a “reality gap” between buyers and sellers, making deals challenging to close.



CONCLUSION

Self storage remains a core real estate asset with superior returns and low loss levels. The sophistication of due diligence will increase over the next year, further separating the market into winners and losers. Value and cap rate elasticity will be a function of local trade area metrics, and less a qualitative reaction of the general market. Market fundamentals by asset, not herd mentality, will determine who is swimming naked. Clearly, investors will continue to store capital in self storage.



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- Retail
- Self Storage
- Senior Housing/Healthcare

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