

Domestic Self-Storage Market

IT'S 1994 ALL OVER AGAIN

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AS THE PACE OF OVERALL CAP RATE EXPANSION SLOWS FOR SELF-STORAGE PROPERTIES, ONE SELF-STORAGE REIT CHAIRMAN SUMMED UP CURRENT MARKET CONDITIONS BY STATING, "IT FEELS LIKE 1994 ALL OVER AGAIN." The rise of this asset class began in 1995 as capital flowed to the self-storage industry. At that time, buyers of self-storage assets enjoyed steady returns in the short run and appreciation over the long run. Nearly 15 years later, our investor Survey shows increased confidence in this

asset class, which many investors describe as recession resistant. Although self-storage revenues have declined over the past several months, they remain relatively stable, especially compared to other asset classes.

While some analysts report that the current recession has resulted in larger declines to self-storage cash flows than the recession in 2001, a recent 14-year time-series study prepared by Cushman & Wakefield (C&W) suggests otherwise. After analyzing over 500 different self-

storage facilities from various operators, C&W's independent market view reveals that self-storage RevPAR (based on rental rates and occupancy for a 10 x 10 unit) declined about 3.35% in the last recession (2001). Over the past year, it has declined 2.90% (see Chart DSS-1).

For the most part, value declines in the U.S. self-storage industry to date have occurred because of overall cap rate expansion, a function of the rising cost of capital for both debt and equity. With the self-storage industry experiencing one of the lowest levels of new construction in asset-class history, occupancy and income are forecast to rise at or above the rate of inflation beginning in mid- to late 2010 as the U.S. economy and banking industry recover. Although some investors feel that inflation will return, it will cause real estate to be a safe haven for investments. Overall, investors remain bullish on investing in self-storage assets.

INVESTING

When analyzing self-storage investments, some investors are placing greater focus on equity dividends. One broker, successful in two portfolio transactions in 2009, noted that overall cap rates are less important to buyers now. According to this broker, an equity dividend of 8.50% is the "trigger rate" for deals. Currently, typical financing terms include an interest rate of 7.00% to 7.25%, a 60.00% to 65.00% loan-to-value ratio, and a 25-year amortization schedule. Such terms suggest an overall cap rate of between 8.50% and 9.00%. If assumable financing is in place, how-

Table DSS-1
DOMESTIC SELF-STORAGE MARKET
Second Half 2009

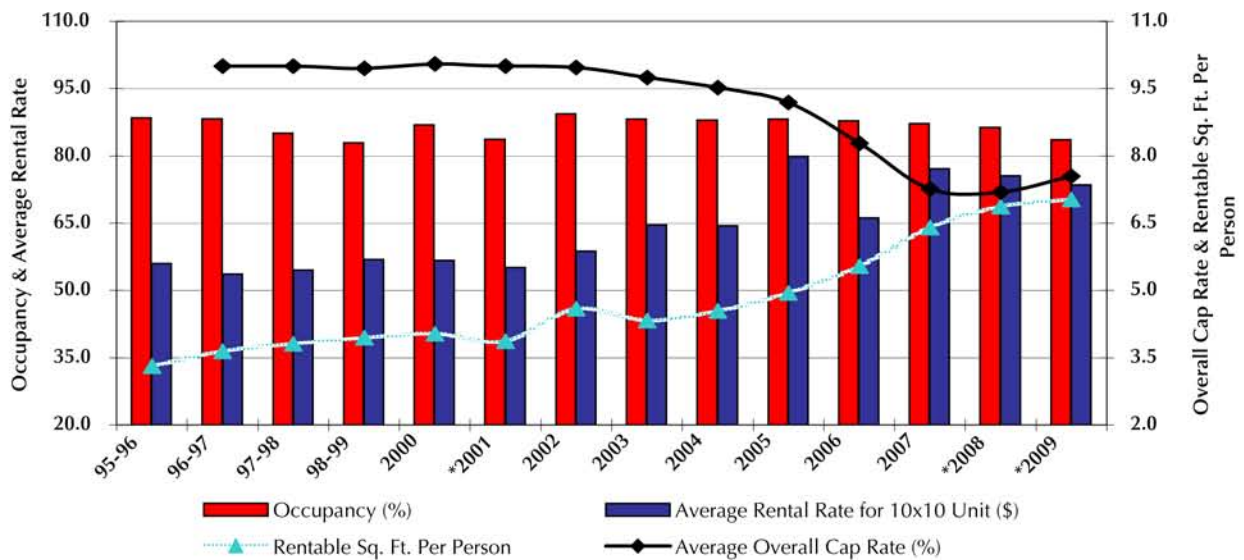
| | SECOND HALF 2009 | FIRST HALF 2009 | SECOND HALF 2008 |
|--|------------------|-----------------|------------------|
| DISCOUNT RATE (IRR)^a | | | |
| Range | 10.00% – 13.00% | 10.00% – 12.00% | 10.00% – 11.00% |
| Average | 11.50% | 11.25% | 10.75% |
| Change (Basis Points) | | + 25 | + 75 |
| OVERALL CAP RATE (OAR)^a | | | |
| Range | 7.00% – 10.00% | 7.00% – 10.00% | 7.00% – 10.00% |
| Average | 8.75% | 8.55% | 8.00% |
| Change (Basis Points) | | + 20 | + 75 |
| RESIDUAL CAP RATE | | | |
| Range | 8.00% – 10.50% | 8.00% – 10.50% | 7.00% – 10.50% |
| Average | 9.00% | 8.75% | 8.50% |
| Change (Basis Points) | | + 25 | + 50 |
| MARKET RENT CHANGE RATE^b | | | |
| Range | 1.00% – 5.00% | 1.00% – 5.00% | 1.00% – 5.00% |
| Average | 3.00% | 2.00% | 2.50% |
| Change (Basis Points) | | + 100 | + 50 |
| EXPENSE CHANGE RATE^b | | | |
| Range | 2.00% – 5.00% | 2.00% – 5.00% | 2.00% – 5.00% |
| Average | 3.00% | 3.00% | 3.00% |
| Change (Basis Points) | | 0 | 0 |
| AVERAGE MARKETING TIME^c | | | |
| Range | 3.00 – 12.00 | 3.00 – 12.00 | 3.00 – 12.00 |
| Average | 11.00 | 9.50 | 6.50 |
| Change (%) | | + 15.79 | + 69.23 |

a. Rate on unleveraged, all-cash transactions b. Initial rate of change c. In months

Source: Cushman & Wakefield

ANNUAL U.S. SELF-STORAGE ALMANAC

1995 through 2009



* Recessionary Period

Source: Cushman & Wakefield

ever, the overall cap rate is lower.

When looking at reported overall cap rates from transferred assets, investors are paying close attention to occupancy levels. If the property was sold at stabilized occupancy, the overall cap rate is considered a good indicator of market value. If a property is either in need of absorption or approaching stabilization, however, dissecting the indicated overall cap rate becomes more complex. In general, buyers are using lower overall cap rates on self-storage properties that are 75.00% occupied and are not giving much credit to vacant space. The challenge is that a seller sees this lower overall cap rate and wants it applied to a stabilized property at 85.00% occupancy. Several brokers complain that this current methodology has led to the overvaluing of certain assets. It has also led to a greater reliance on discounted cash flow analyses.

Many brokers have reported an increase in deal flow in the last 90 days as the bid-ask pricing gap begins to narrow between buyers and sellers.

Financing has also loosened, as one major REIT significantly revised their balance sheet with \$125.0 million in new capital raised mostly from community and regional banks. While lending for stabilized single assets is available, portfolios of up to ten properties have also been financed with new bank funds in the second half of 2009. In the third quarter of 2009, however, the Federal Reserve Bank of New York granted approval for self-storage properties to be leveraged in single-sponsor, TALF-eligible CMBS transactions. Liquidity may be described as dripping, but at least the pipe is not completely blocked.

SURVEY FINDINGS

Increases in both the average overall cap rate and the average discount rate for the industry have shrunk over the past six months in comparison to the first six months of 2009. As shown in Table DSS-1, the average overall cap rate increased 20 basis points in the last six months of this year. By comparison, it increased 55 basis points during the first six months. For the average discount

rate, the recent increase is 25 basis points compared to 50 basis points. These downward trends suggest that this industry is stabilizing from an investment perspective. Most Survey respondents indicate that overall cap rates should level out at around 9.00% or less.

While public self-storage REITs are reporting dividends between 4.00% and 7.00%, the largest nonpublicly traded self-storage REIT (Strategic Storage Trust or SST) offers a 7.00% dividend. Yet, due to management and administrative costs, a higher internal dividend is required, resulting in overall cap rates between 8.00% and 9.00%. SST was one of the largest buyers of single self-storage assets in the country in 2009. ♦

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