Domestic Self-Storage Market

Acquisitions Drive Cap Rate Declines

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When combined with healthy fundamentals and a limited number of quality offerings, the strong desire among investors to acquire both single assets and portfolios in the domestic self-storage market continues to compress overall capitalization (cap) rates in this property sector. "Due to a bullish outlook for the self-storage sector in general, increased competition among buyers is causing overall cap rates and marketing times to decline," says a self-storage broker. In fact, one national investor, who has been very active during the past 18 months, expressed frustration in obtaining new product stating, "There just isn't enough for sale."

As shown in Table DSS-1, the investor survey completed by Cushman & Wakefield (C&W) shows that the average overall cap rate for the domestic self-storage market declined 20 basis points over the past six months. While overall cap rate compression continues, the pace of decline has slowed during the last two quarters. As shown in Chart DSS-1, the average overall cap rate declined 100 basis points in 2010 but only 45 basis points in 2011. About 18 months ago, C&W estimated that this sector's average overall cap rate would return to its prerecession level of roughly 7.25% within two years. The current data indicates that this level has nearly been achieved, but in less time than initially forecasted.

Table DSS-1
DOMESTIC SELF-STORAGE MARKET
Second Half 2011

	SECOND HALF 2011	FIRST HALF 2011	SECOND HALF 2010
DISCOUNT RATE (IRR)[a]			
Range	9.50% – 11.50%	10.00% – 12.00%	10.00% – 12.00%
Average	10.25%	10.50%	10.75%
Change (Basis Points)		– 25	– 50
OVERALL CAP RATE (OAR)[a]			
Range	6.50% – 8.75%	6.75% – 9.50%	7.00% – 9.50%
Average	7.30%	7.50%	7.75%
Change (Basis Points)		– 20	– 45
RESIDUAL CAP RATE			
Range	7.00% – 9.00%	7.00% – 9.25%	8.00% – 10.50%
Average	7.50%	7.75%	9.00%
Change (Basis Points)		– 25	– 150
MARKET RENT CHANGE[b]			
Range	1.00% – 5.00%	1.00% – 5.00%	1.00% – 5.00%
Average	3.25%	3.50%	3.50%
Change (Basis Points)		– 25	– 25
EXPENSE CHANGE[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 – 9.00	3.00 – 9.00	3.00 – 9.00
Average	4.00	5.00	5.00
Change (%)		– 20.00	– 20.00

a. Rate on unleveraged, all-cash transactions b. Initial rate of change c. In months
Source: Cushman & Wakefield

Investment Activity

Recent self-storage acquisitions show that portfolios remain popular among investors. Since April 2010, at least 12 self-storage portfolio sales have occurred, ranging from $20 million to half a billion. In the last six months, there has been over $1.0 billion in portfolio activity in six transactions.

Single-asset sales in the self-storage sector are at their highest level since 2007, according to data provided by CoStar. In addition, pricing is at its highest level since 2008 with an average price of $72.96 per square foot.

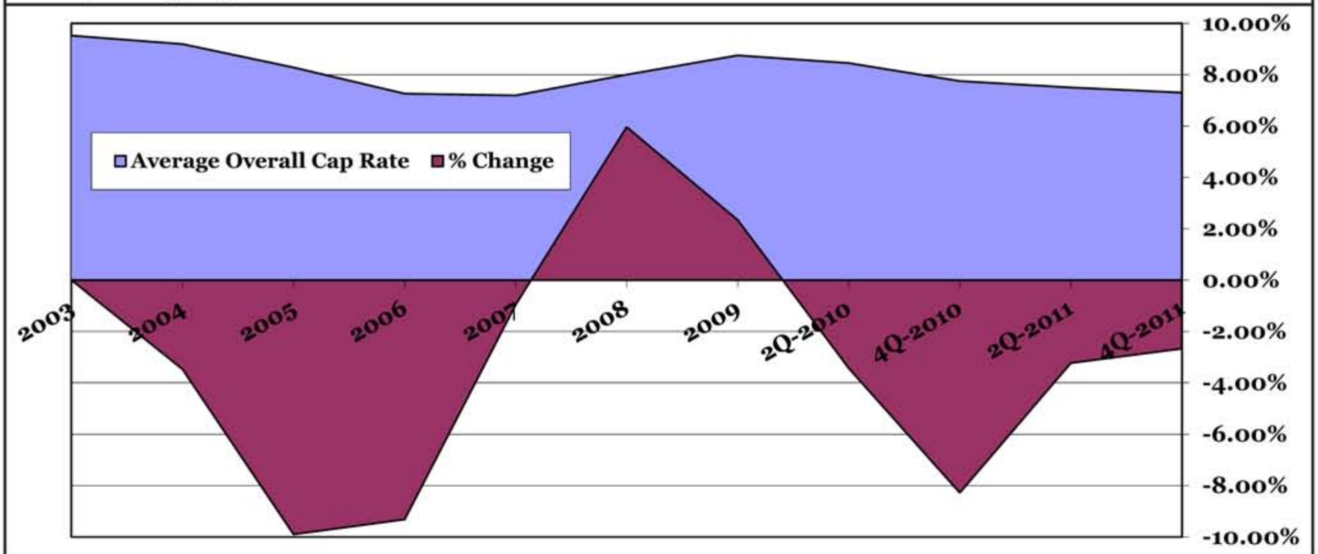
Self Storage by Class

Drilling down into the sales data reveals that there has been high demand for quality, stabilized self-storage facilities in the last 20 months. As the availability of such product has become limited, the willingness to purchase unstabilized, "lower quality", or "value add" assets has grown among buyers. As a result, investors are increasingly looking to classify self-storage assets.

Chart DSS-1

AVERAGE OVERALL CAP RATE TRENDS

2003 through 4Q 2011



Source: Cushman & Wakefield

According to Charles Ray Wilson, MAI, CRE, the founder of Self Storage Data Services, the need for standardization in the self-storage industry is long overdue. Mr. Wilson has drafted the following guidelines for classifying self-storage assets. These classifications can vary significantly in local markets and relate best to the top-100 metro areas in the country.

- Class-A facilities have excellent locations, access, and superior construction and finish. They are relatively new or competitive with new facilities and provide professional on-site and off-site management. Class-A facilities are typically located in markets with high barriers to entry and are characterized by above-average maintenance and security systems.

- Class-B facilities have average locations, access, and visibility. These facilities compete at the low end of Class-A facilities and achieve rental rates below Class-A assets, but above Class-C facilities. They receive average to good maintenance and have a full-time on-site manager and competent off-site management. Quality of construction and security are both rated average to good.

- Class-C facilities generally have secondary locations relative to tenants' needs. They often have poor access, limited visibility, and are typically older with growing functional and/or economic obsolescence. They achieve rents at the bottom of the range in the marketplace. These facilities are often owned and operated by individuals and may not have an on-site manager. Quality of construction and maintenance are both rated fair to average. Often, these facilities have minimal or no security and receive below-average care.

In terms of overall cap rates, investors consider the gap between Class-A and Class-B assets to be much smaller than the gap between Class-B and Class-C properties. According to investors, overall cap rates for Class-A self-storage assets can fall below 7.00%, but they tend to hover near the low- to middle-7.00% range for Class-B facilities. In general, investors indicate that overall cap rates for Class-B assets are 25 to 50 basis points higher than Class-A assets. For Class-C facilities, however, the spread increases to as much as 100 basis points. As a result, a Class-C facility may have a stabilized cap rate as high as 8.50% in the current market.

It is important to note that these spreads reflect a typical range based on the current views of investors and market participants. As such, there are likely data points and transactions that are outliers to these estimates.

The Year Ahead

The outlook for the domestic self-storage market is one of optimism given limited additions to supply and strong consumer demand. In turn, fervent investment interest is expected to continue, keeping overall cap rates down. While most investors will likely focus on Class-A facilities, the desire for higher yields could boost sales activity of Class-B, and even Class-C, assets in the year ahead. ✦