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2019 Self-Storage Market Report

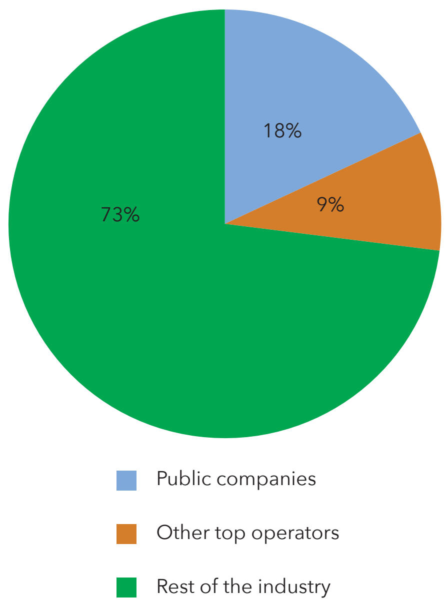
Self-Storage Sector Trends

Best operating strategies and practices for the self-storage sector have evolved over the years as the industry has grown and matured. In the earliest days of the asset class, most facilities were small, independent businesses run by sole proprietors. Today, mom-and-pop operations remain common, but the industry has experienced a dramatic shift toward career management professionals. As recently as five years ago, more than one-third of managers fell into the owner-manager category. This number has declined almost every successive year, and currently, only a bit more than 10 percent of storage facilities are managed by the owner.

It isn't just management style that has changed. The average self-storage facility itself has changed over time. While first-generation storage properties showcased row after row of single-story metal buildings equipped with bright orange roll-up doors, the self-storage stores being constructed today often mirror the styles used in neighboring structures, with upscale architectural features and highly detailed exterior design plans that blend in with the surroundings.

Strong customer service and ancillary services are becoming a top priority for self-storage consumers. Over 75 percent of self-storage operators now report the sale of ancillary items at their facilities, including boxes, moving supplies and moving vehicle rentals. In addition, over 65 percent of operators sell insurance at their facilities, a 12 percent increase over the past 12 months. Car washes are becoming a common attraction at self-storage facilities. Although more common with high-service facilities that include RV-, camper- or boat-storage facilities, 6 percent of facilities now report an on-site car wash.

Industry ownership by number of facilities



Source: MiniCo Publishing

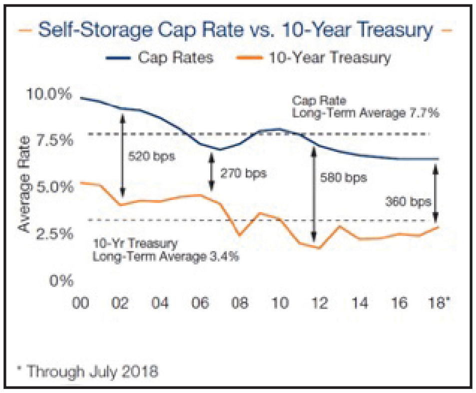
Beyond the sector's largest operators, the segment is highly fragmented and competitive. The combined market share (by square footage) of the 10 largest operators is 32 percent.

The industry has hundreds of mid-size companies operating chains of from three to 100 stores, the vast majority of which are owner-operators. There are still more than 26,000 single-facility owner-operators.

National Market Fundamentals

According to REIS.com, as of the third quarter of 2018 (the most recent data as of the date of this report), the national vacancy rate was 11.8 percent, up 60 basis points over the mid-year 2018 vacancy rate, up 140 basis points over the level found one year ago, and up 260 basis points from the cycle-low vacancy rate of 9.2 percent, found during the second quarter of 2016. Marcus and Millichap reported a similar increase of 40 basis points to reach a vacancy rate of 10.0 percent within its *2018 Second Half Outlook*. The Marcus and Millichap report notes that demand for storage space continues to strengthen with a healthy job market and rising wages. Though demand is near peak, new construction has pushed beyond demand, forcing the vacancy to increase, although the vacancy rate has hovered in the same range for the past year. Areas of oversaturation already exist, characterized by greater concessions, lower occupancy and negative rent growth. Nonetheless, on the whole, the market remains intact. Despite predictions of doom and gloom, the reality is a more balanced market than analysts had forecast.

Self-storage has historically seen much greater swings in fundamentals year over year than the other major commercial real estate product types,



as is evidenced by the 230-basis-point increase in vacancy rate between the third quarter of 2017 and the third quarter of 2018.

The forecast nationally is for vacancy rates to rise, albeit at a slower pace than had previously been forecast. Elevated consumption related to increasing multifamily lifestyles, where residents don't have room to accommodate all of their belongings, will result in stable demand. New development, however, will outpace demand in 2019. The forecast from REIS called for a vacancy rate of 12.8 percent by year-end 2018, with a stabilization thereafter, and the vacancy rate remaining under 13.0 percent throughout the five-year forecast horizon.

Asking rental rate growth across the nation was positive in 2018, with rental rate escalation forecast (when year-end numbers are completed) at 1.3 percent for non-climate controlled and 0.5 percent for climate-controlled. The average monthly rental rates for the five most common unit sizes are outlined below.

Investment Market

According to the Marcus and Millichap *Second Half 2018 Self-Storage Report,* the self-storage investment market continues to remain strong, as properties are in high demand. Both institutional and private buyers are pursing self-storage opportunities with higher yields, amid weak returns from core real estate holdings. Competitive bidding has advanced the average price per square foot by 11 percent over the 12-month period ended June 2018. For recently traded assets, the average initial cap rate is in mid-6 percent range, down from the low-8 percent range of 2010.

Overall, higher sales prices are enticing owners to bring their assets to market; however, higher borrowing costs are narrowing the margin for buyers. In order to maintain yield, many REITs are now pursuing Class B and secondary market opportunities, where they had historically only invested in Class A product located in top-tier markets. Lenders will remain active in providing financing for self-storage opportunities, although many capital providers have become increasingly selective as they reassess risk.

On a regional basis, the average price per square foot increased in all regions of the nation. The greatest price increase was in the Midwest region of the nation, where pricing increased by 9.6 percent to an average of $80 per square foot. The highest pricing in the nation is the Northeast region where pricing averages $175 per square foot. As of mid-year 2018, the long-term average self-storage cap rate was 7.7 percent, as compared with a 10-year treasury long-term average yield of 3.4 percent. A summary of the historical average cap rate over the past several years and a comparison to U.S. Treasury rates may be found to the left.

Conclusion

In summary, we acknowledge that with any commercial real estate investment offering the asset must be underwritten on a submarket basis, and such market conditions may vary substantially. Historically, self-storage has experienced greater swings in vacancy and rental rate fundamentals and are, therefore, less predictable financial performers than other asset classes. We also acknowledge that the current state of the storage market is healthier than we predicted in June 2018, based then upon the Q1 2018 data. However, the reversion to the mean on vacancy rates that we discussed then is playing out on a national basis as vacancy rates are now in the double digits and expected to creep up another 120 to 300 basis points, depending on the forecast source. We continue to believe that cap rates will also increase further, and considering the historical spreads over an 18-year period reflected in the chart above and the anomaly of circa 2007, cap rates in many markets may approach and exceed 8 percent in 2019.

Average monthly rental rates for common unit sizes

Unit Type	5X5	5X10	10X10	10X15	10X20
Non-climate-controlled	$58.01	$ 79.80	$123.12	$159.00	$189.71
Climate-controlled	$70.71	$100.26	$156.02	$203.14	$252.03

For a copy of the full report, contact us at:
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