

## SELF STORAGE INDUSTRY OVERVIEW

The Market Overview forms a basis for assessing market area boundaries, supply and demand factors, and indications of the subject's position within the market. The following market analysis is based on the review of the Self-Storage Almanac and specifically the Tampa-St. Petersburg-Clearwater, Florida area. The Self-Storage Almanac conducts an annual survey of self-storage facilities both regionally and statewide. In addition, we have included the self storage market overview from the Korpacz Real Estate Investor Survey at the end of this overview.

**Customer Base:** Per the Self-Storage Almanac, self-storage facilities, although usually falling under industrial zoning regulations, are more like neighborhood shopping centers in that they must draw customers from within a relatively small radius to be competitive. The majority self storage customers seek facilities within a three to five mile radius of their main location. The density of development and the location of competitors in the submarket primarily influence the trade area ring.

Residential customer tenancy has dropped from 74.8% in 2007 to 73.8% in 2008, while the commercial tenancy has increased from 18.9% to 20.6% from 2007 to 2008. This is the lowest residential percentage and the highest commercial percentage since 2002. Residential tenants may be cutting this cost due to the economy, while self storage utilization is becoming more standard for businesses. In the subject's submarket (Southeast) the customer base is also heavily residential (72.8%) with the average stay of approximately 14.5 months. However, business customers can be an attractive part of the base since the commercial patron typically rents for an average of 22.8 months in the Southeast.

**Rental Rates:** Rental rates are affected by a variety of factors, from the larger economic picture to occupancy rates, local market dynamics, competition, services offered, incentives, advertising, and the location and age of the facility. Per the Self-Storage Almanac, rental rates in the United States decreased in 2007 from the highs experienced in 2006, with the exception of the 10'x20' unit size. However, in 2008 the national rental rates increased over 2007 numbers, again with the exception of the 10'x20' unit size. In the subject's submarket (Southeast) rental rates followed a similar pattern as the nation, with all unit sizes indicating increasing rental rates from 2007 to 2008. The following table indicates the average rental rates for each respective size ranging from 5'x5' to 20'x20'. The table summarizes the rates over the period 2004 through 2008, as well as the percentage increase in the rate over the last year.

SOUTHEAST REGION RENTAL RATES						
Unit Size	2004	2005	2006	2007	2008	% Change 07'-08'
5'x5'	\$31.40	\$30.76	\$38.24	\$35.52	\$40.76	14.8%
5'x10'	\$43.09	\$44.09	\$52.98	\$51.25	\$55.04	7.4%
10'x10'	\$67.00	\$64.84	\$79.39	\$75.80	\$84.18	11.1%
10'x15'	\$85.39	\$86.74	\$103.92	\$98.97	\$107.95	9.1%
10'x20'	\$104.64	\$103.00	\$125.10	\$117.10	\$133.86	14.3%
10'x25'	\$123.73	\$125.14	\$145.36	\$137.47	\$154.08	12.1%
10'x30'	\$138.12	\$145.10	\$166.55	\$169.88	\$173.30	2.0%
20'x20'	\$197.42	\$187.21	\$189.11	\$200.96	\$202.95	1.0%

Based on the above, rates with the subject's submarket have increased from 1.0% to 14.8% over the last year, depending on the unit size. The 2008 rates are at the highest level in the last five years.

**Occupancy Rates:** The self storage industry is known for its ability to withstand economic downturns. However the industry did show signs of the economy's effect in terms of occupancy declines, albeit moderate declines in most regions. With fewer people transitioning into new homes, and facing the increasing costs of necessities, self storage facilities have recently found it more difficult to attract and retain tenants. Nationally, the average occupancy for self storage facilities is 80.3%, down from 81.4% one year ago. In the subject's submarket (Southeast), the occupancy is lower than the national average, at 77.2%.

It has also become more difficult for new facilities to stabilize, or reach the critical 70% physical occupancy mark. Approximately 21% of new facilities are taking more than 24 months to reach this point, up from just 9% one year ago. Fewer facilities are experiencing shorter lease-up times, with only 10% taking less than 6 months, compared to 16% one year ago. The largest share of facilities, 20%, required between 6 months to one year to reach 70% occupancy.

**Conclusion:** The self storage industry has historically been less vulnerable to economic downturns. While occupancy rates have decreased, this decrease has been very minimal. In addition, rental rates have increased over the last year, with every unit size indicating an increase in the subject's submarket (Southeast). Overall, the self storage industry appears to be in much better shape than most other sectors of real estate, and we would expect this segment of the market to continue to perform well and improve as the economy recovers over the next few years.

# Domestic Self-Storage Market

## STABILITY IN AN UNCERTAIN TIME

By R. Christian Sonne, MAI, MRICS

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**INVESTORS STORING CASH IN THE SELF-STORAGE INDUSTRY CONTINUE TO FEEL OPTIMISTIC EVEN THOUGH THE U.S. ECONOMIC RECESSION AND CAPITAL MARKET DEPRESSION HAVE NEGATIVELY IMPACTED RENT INCREASES AND OCCUPANCY.** In addition, financing remains very difficult to obtain even in strong markets as deleveraging continues, causing overall cap rates and yield rates to rise.

Interest in this asset class, particularly from private equity firms, continues to increase because of steady cash

flows, high returns, and low loss ratios. In addition, investors like the fact that there are no tenant improvement costs or leasing commissions and limited large capital expenditures. Despite investor interest, closed deals are a rarity now. One broker in Arizona reports that there are currently 41 self-storage facilities for sale within the state, but no sales have been reported thus far in 2009. Similarly, a California broker reports that only two self-storage assets have traded in the state year to date.

On a positive note, new construction has slowed considerably. Some estimate that less than 250 self-storage facilities will be constructed in 2009 nationwide, a huge decline from the peak pace of 2,500 about four years ago.

### LENDING

Strong owners seeking financing indicate that favorable long-term debt (65.0% loan-to-value ratios, interest rates ranging from 7.00% to 7.50%, 25-year amortization, and debt coverage of 1.20) is increasingly difficult to find. In one recent instance, a seasoned regional operator with 20 self-storage facilities was facing a loan renewal. The lender would not discuss the deal with them even though the loan involved a stabilized asset, strong sponsorship, and was current in payments. While the loan was eventually renewed for one year at the same terms, this scenario illustrates the trepidation among lenders, as well as their growing preference to renew deals for shorter terms of six months to three years rather than structure new, long-term loans.

### SURVEY FINDINGS

Overall cap rates have continued to increase at a pace of 8 to 10 basis points a month over the past year in response to macroeconomic challenges and credit market concerns. As shown in Table DSS-1, the average overall cap rate of 8.50% stands 50 basis points higher than the average six months ago. The overall cap rates reported for this market reflect stabilized, Class-A/B self-storage facilities in suburban areas.

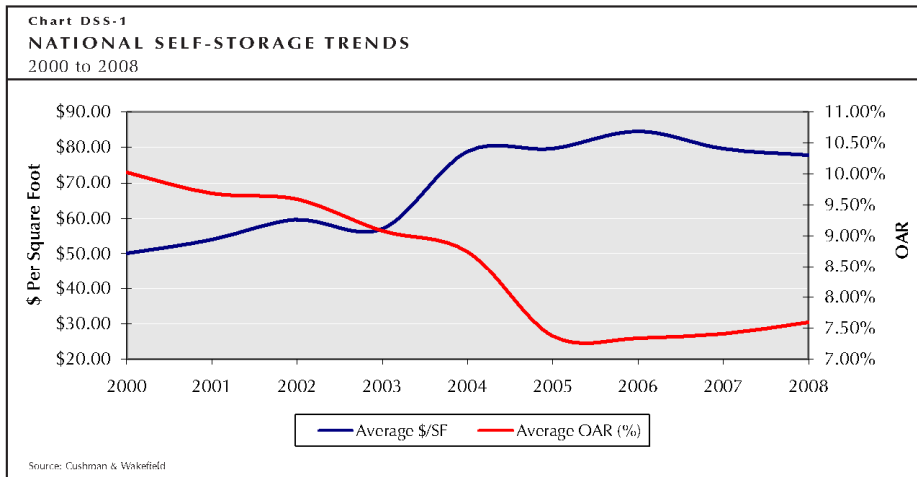
Some respondents expressed hope

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

	FIRST HALF 2009	SECOND HALF 2008
<b>DISCOUNT RATE (IRR)<sup>a</sup></b>		
Range	10.00% – 12.00%	10.00% – 11.00%
Average	11.25%	10.75%
Change (Basis Points)		+ 50
<b>OVERALL CAP RATE (OAR)<sup>a</sup></b>		
Range	7.00% – 10.00%	7.00% – 10.00%
Average	8.55%	8.00%
Change (Basis Points)		+ 55
<b>RESIDUAL CAP RATE</b>		
Range	8.00% – 10.50%	7.00% – 10.50%
Average	8.75%	8.50%
Change (Basis Points)		+ 25
<b>MARKET RENT CHANGE RATE<sup>b</sup></b>		
Range	1.00% – 5.00%	1.00% – 5.00%
Average	2.00%	2.50%
Change (Basis Points)		- 50
<b>EXPENSE CHANGE RATE<sup>b</sup></b>		
Range	2.00% – 5.00%	2.00% – 5.00%
Average	3.00%	3.00%
Change (Basis Points)		0
<b>AVERAGE MARKETING TIME<sup>c</sup></b>		
Range	3.00 – 12.00	3.00 – 12.00
Average	9.50	6.50
Change (%)		+ 46.15

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

Source: Cushman & Wakefield



that the upward trend in overall cap rates would ease by the third or fourth quarter of 2009 as capital market pressure begins to subside. As one investor predicts, "We may not be at the bottom by then, but we should be able to see the bottom by then."

Similarly, yield rates are also rising but at a slower pace than overall cap rates. This is primarily a function of slower growth rate assumptions used in estimating net operating income and cash flow. As more investors use discounted cash flow analysis, replacement reserves, rarely applied in self-storage asset analysis in past years, are now becoming a common "below-the-line" expense at a range of \$0.10 to \$0.15 per square foot.

#### BUYERS AND SELLERS

The pricing gap between buyers and sellers remains wide. In one recent unsuccessful deal, a 50-asset portfolio failed due to bids involving 9.00%-plus overall cap rates. The seller expressed caution over selling to "grave dancers" while the buyer had concerns about the strength and durability of the cash

flow during a recession.

Despite these issues, confidence exists for self-storage ownership due to its relatively stable cash flows. In fact, many Survey participants indicate that the self-storage industry is "recession resistant." Still, investor caution does exist, and most respondents estimated that cash flow (measured by occupancy and income) has declined 5.00% or less as a result of the recession.

Currently, investors are poised for acquisitions, but waiting for markets to bottom out. Meanwhile, due diligence continues as investors separate the winning trade areas from the oversupplied ones. In general, investors are staying away from self-storage properties that were developed in growth markets that were waiting for rooftops to be constructed. Offerings most attractive are in small to large portfolios with a minimum of five properties within one city. This allows for management efficiency, not occupancy, to drive a "value-add" acquisition's rate and yield.

Investors also suspect that industry consolidation is likely in the months ahead. Approximately 80.0% of self

storage is noninstitutionally owned or operated.

#### CONCLUSION

In the near term, self-storage cash flow is expected to remain stable relative to other asset classes. Over the long run, this trend will attract equity and capital financing. As a result, overall cap and yield rates should stabilize as transaction volume increases and the industry consolidates. In Chart DSS-1, pricing met overall cap rates near 9.00% in mid-year 2003. This may suggest that overall cap rates will stabilize near 9.00% going forward. In the meantime, as one self-storage operator said of this interim period of waiting for the recovery, "Meanwhile, I'll sit back and enjoy my cash flow." ♦

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