SELF-STORAGE

A Resilient Asset Class That Will Continue to Perform Well Through Downturn

THE SELF-STORAGE ADVISORY GROUP
CUSHMAN & WAKEFIELD
MIDYEAR 2020

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Cushman & Wakefield's COVID-19 Recovery Readiness Guide

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SELF-STORAGE OVERVIEW

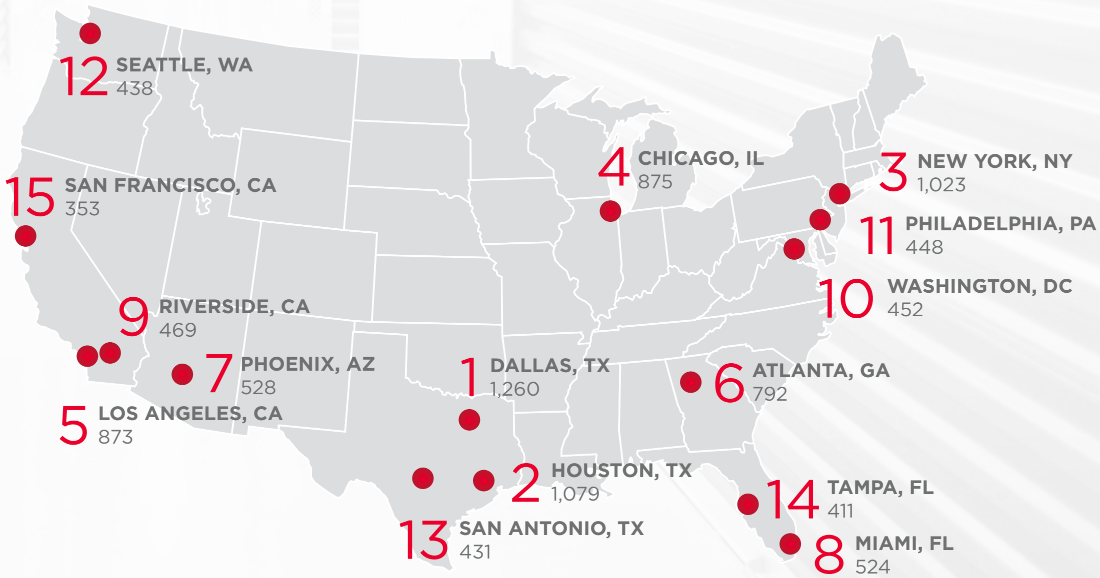
Pre-COVID-19, the self-storage market was on an upward trajectory. Construction spending had slowed down, facilities were leasing up, and demand for self-storage product was strong. Since the pandemic began, rental activity is down, both with move-ins and move-outs. Some tenants will vacate units due to financial constraints over the next several months. As the economy opens back up, self-storage will bounce back as it did after the Great Recession of 2007/2009.

Self-storage had a tremendous amount of growth in recent years in terms of new construction and investor interest. As inventory increased, a growing number of first-time self-storage investors dove into this niche sector. Advantages of self-storage include increased household penetration, strong population growth in the U.S., and the sector's resilience compared to other asset classes.

Ownership within self-storage is fragmented. Roughly 20% of the market is owned by the five largest REITs (Public Storage, Extra Space, CubeSmart, Life Storage and NSA) while the remainder is owned mainly by small operators. Over the last decade, private equity groups established a major presence by purchasing smaller operators in larger markets. These smaller operators lacked institutional standards, drawing minimal interest from REITs and major buyers.

TOP 15 SELF-STORAGE MARKETS

by number of facilities



Over three-quarters of the tenant base for self-storage come from residential users as the industry tends to follow population growth and patterns. In the last decade, the trend with millennials moving to dense urban areas fueled growth in the sector as many residents required additional storage living in more vertical neighborhoods. One potential shift due to COVID-19 would be a return by individuals and couples moving out of urban cores and to suburbs or exurbs to escape the populous cities.

SELF-STORAGE MARKET BY THE NUMBERS

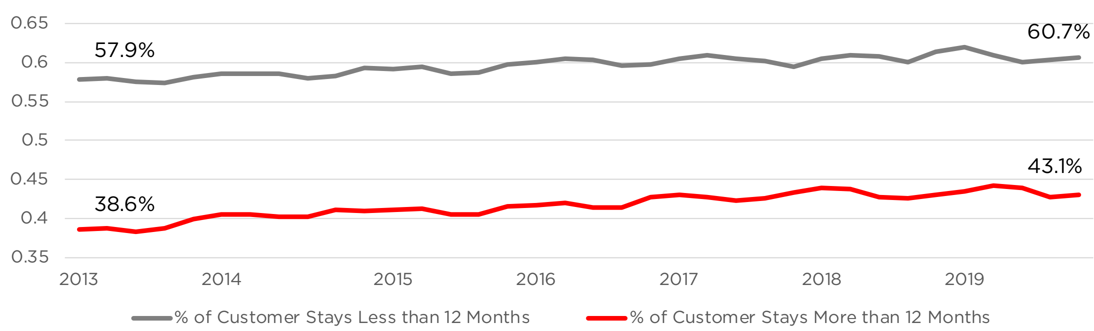
Annual industry revenue	$39 Billion
Number of storage facilities (range)	**55,000-60,000**
Total rentable self-storage space	1.7 Billion Square Feet
Self-storage space per person	**5.4 Square Feet**
Percentage of households that rent a self-storage unit	9.4 Percent
Average monthly cost for a self-storage unit	**$87.89**
Average length of Stay (Public Storage)	10 Months

Source: SSA, Cushman & Wakefield Research, Sparefoot, REIT Earnings Reports

MONTH-TO-MONTH USUALLY MEANS YEARS

Self-storage is traditionally rented on a month-to-month basis, though many tenants stay for much longer. As an example, approximately 43% of the Extra Space Storage tenants stay for a period of more than 24 months. The statistic is common in the industry and is a very good sign for owners of self-storage. It demonstrates a recurring revenue stream and more stable asset type. In fact, owners are able to raise rent monthly which can have a considerable impact on revenue the longer a tenant occupies a unit. On the flip side, if tenants fall behind and do not pay rent, items stored in the units are collateralized and then sold at auction.

LENGTH OF TENANT STAY



Source: Extra Space Storage Investor Presentation

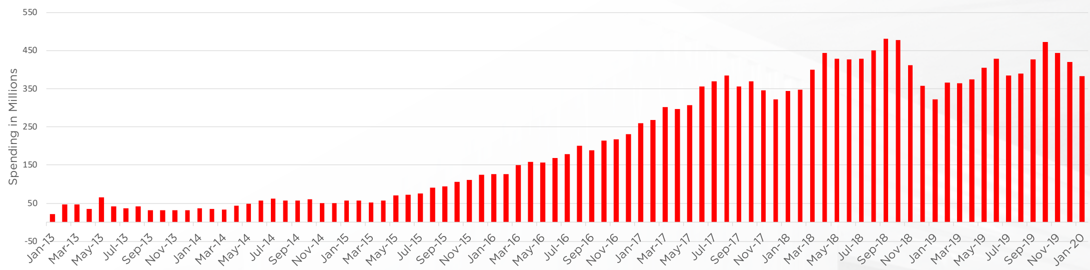
UPSIDE IN SELF-STORAGE INVESTING

Self-storage achieves some of the highest NOI margins for any real estate asset type, upwards of 60%-70%. The sector allows property owners to capitalize on growth with tremendous upside. The bulk of expenses for owners in storage facilities are property taxes, management fees and advertising.

Property taxes vary depending on the state and county levels, and on average account for 30% of a property's expenses. Management fees, both off-site and on-site, average out to 35% of overall expenses. The on-going capital expenditures that a self-storage facility accrues is very low compared to the other asset classes. Advertising expenses are on the rise, as costs for Google, Sparefoot and other social media outlets continue to grow. Public Storage had almost a 60% increase year-over-year costs in the first quarter of 2020. We expect online advertising to increase with stay-at-home orders in place to help draw customers in when people start moving again. Due to the impact of the Covid-19 virus Public Storage plans to increase the pay by $3.00 per hour to virtually all property managers and increase paid time off benefits until June 30, 2020.

OVERSUPPLY IN NEW SELF-STORAGE DELIVERIES

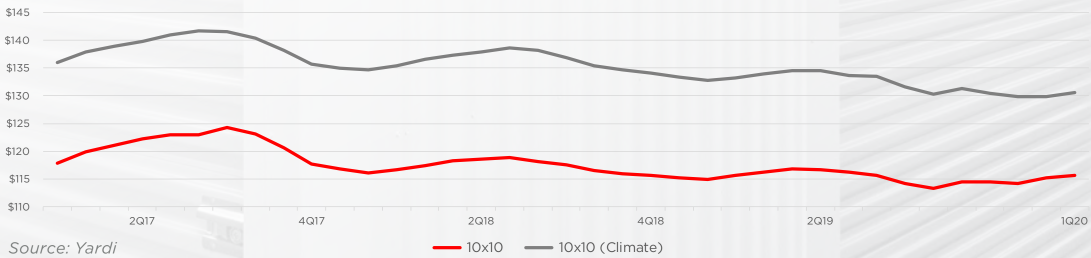
SELF-STORAGE CONSTRUCTION SPENDING



Source: U.S. Census Bureau

Construction spending on self-storage assets exploded in the last five years. According to the U.S. Census Bureau, construction spending on self-storage has increased 584% from January 2015 to January 2020. Peak spending on self-storage was in 2018, while new deliveries remained high for 2019. We expect a gradual decrease over the coming years due to the economic recession and many markets being oversupplied or at capacity. Yardi Matrix expects new deliveries for self-storage facilities to decrease 52% by the year 2023.

ASKING RENTAL RATE HISTORY



Source: Yardi

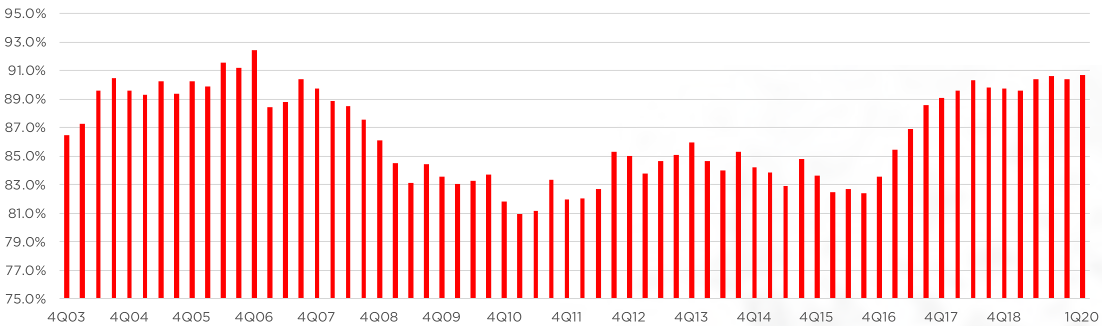
Throughout the nation, rental rates gradually declined over the last three years. Yardi Matrix reported a 4% decrease from March 2017 to today nationally. The decrease was mainly due to new supply being delivered. As new facilities leased up, existing stabilized facilities typically saw a drop in asking rents in order to retain customers. As more and more new units deliver, a snowball effect occurs and rents continue to soften. This played out in Portland, Oregon, where rental rates dropped by ten percent in three years on 10x10 climate-controlled units.

COMPARISONS BETWEEN THE GREAT RECESSION AND COVID-19

The Great Recession of 2007/2009 had a profound impact on the real estate industry, including self-storage. At its peak, the unemployment rate was up to 10%. With COVID-19, the Bureau of Labor Statistics recorded in April 2020 the seasonally adjusted unemployment rate was 15.5%.

- **During the past recession,** rental rates for self-storage in the top 50 MSA's fell approximately 2-3% during the first year.
- **Rental rates continued to decrease** between 0% and 2% annually until 2012 when rates started to climb.
- **In 2015,** rental rates in numerous markets had reverted back to pre-recession levels.
- **Rents stagnated on new supply** which increased after 2014. As those facilities stabilized around 2017/2018 rates started to improve.

TOP 50 MSA | PHYSICAL OCCUPANCY



Source: Self Storage Data Services, Cushman & Wakefield Research

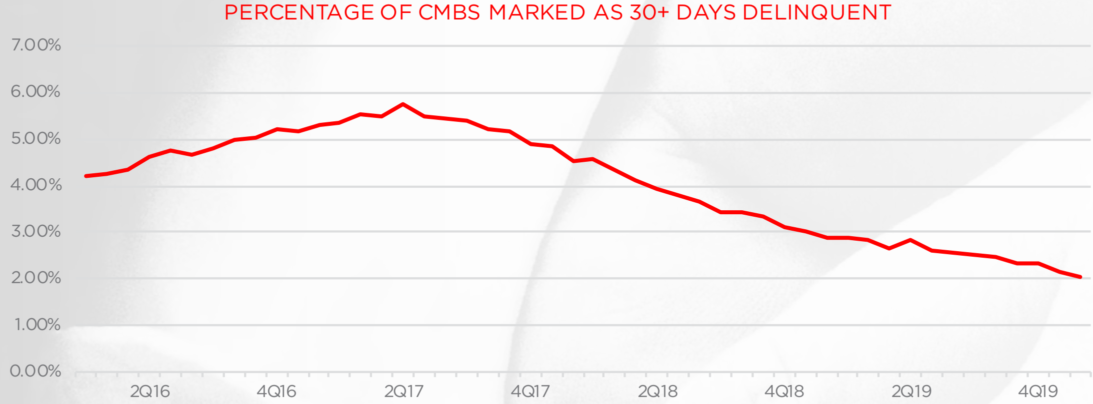
The momentum that started in 2017/2018 has slowed due to the pandemic. Extra Space reported a 9.5% year-over-year decrease on effective rates for new tenants during the month of April 2020. It is too soon to tell where we think rental rates will be in the next year or two, but a rate freeze on existing tenants and a decrease in asking rates for new tenants is to be projected in the near term.

Going forward, rental rate decreases will affect lease-up facilities more than stable facilities who already have a tenant base. NOI on stable assets won't change dramatically and might even go up with rent increases on longer term tenants. Lease-up facilities will face a steeper challenge. NOI will initially go up on a yearly basis due to new tenants leasing units but rental income will be at a lower basis than projected since the initial asking rate will be less. Depending on the pace of recovery, lease-up facilities could take a year or two longer to reach stabilization

Prior to the Great Recession, physical occupancy in the top 50 MSAs were holding steady around 88%-90% but slumped gradually to 80% by 2011. Physical pre-occupancy did not get back up to 90% until 2017. In April 2020, several REITs were reporting a drop-in occupancy between 40 and 60 basis points compared to last year's numbers. At the start of 2008, economic occupancy, the percentage of potential gross income that a self-storage property achieved, was 80% in the top 50 MSAs. This fell to a low of 72% in the first quarter of 2010. They did not rise above 80% until 2017, meaning it took more than eight years to rise back to pre-recession levels.

Concessions increased during the Great Recession from around 7%-8% to over 11% by the first quarter of 2010. Delinquencies initially increased but were back to their normal levels of 8% by 2011. If the market tracks similar to the last recession, concessions will escalate to begin with but should stabilize as the economy recovers.

LENDING ENVIRONMENT



Source: TREPP, 2020

CMBS loan delinquencies during the Great Recession were at a high of 9.01%. Fitch Ratings expects CMBS loan delinquencies for all property types to rise to a peak between 8.25% and 8.75% in the 3rd quarter of 2020. In March 2020, delinquencies were declining and reached 1.31%. Most delinquency payments will be in the hospitality and retail sectors, but the effect will trickle though all asset types. Projected increases in delinquencies will mean a steady fall of new CMBS issuance in the subsequent quarters.

In the near-term we should look for commercial real estate lending conditions to improve for lower risk deal profiles. Sustained low debt costs will relieve upward pressure on cap rates for core self-storage assets. Overall improvement in debt market liquidity will ultimately translate into equity investors returning to the market. In the case of both the equity and debt markets, activity will continue to be restrained by elevated uncertainty.

FINAL WORDS

Until the second half of March and the start of the pandemic, self-storage operations were strong.

- **Rate increases on existing tenants** have mostly been put on hold by REITs and asking rates for new tenants declined as well.
- **Collections dropped slightly**, but REITs have stated some of that drop is intentional as they have been less aggressive in pursuing collections on past due accounts for the time being. Collections could start picking up again in May.
- **Short-term NOI could take a hit** and be flat to negative for the remainder of 2020.
- **Investment activity paused** with most deals far down the pipeline still set to finalize.
- **Like most other deal activity**, acquisitions for self- storage are expected to be limited in the near term.
- **Many REITS are watching closely** for the potential to acquire assets or are looking to pick up below market deals from their management pipelines. Leveraged projects that are not meeting performance metrics may be targets.
- **Some well capitalized REITs** (notably Public and EXR) have stated on earnings calls that they are looking at opportunities as sites come to market. Life Storage, another REIT, indicated a pause on acquisitions for the time being.

Self-storage remains relatively resilient with minimal fundamental changes to underlying drivers of demand in the long-term. The near-term shocks to NOI, including flattening or declining rental rates for the remainder of the year will be felt. The increase in delinquency rates in April were not as pronounced as the market feared with the true impact to surface in May and June. COVID-19 related declines in traffic and leasing, as well as a rise in collections will have an immediate impact. Well-established virtual marketing practices and e-payment platforms will help mitigate some of the challenges. Cash flows in the next two years could take a hit in several different areas, including reduced rent growth rates (in-place and market), lower additional income streams, diminished stabilized occupancy levels or increased credit loss.

We expect move in rental rates to drop for the remainder of 2020 and overall NOI to remain flat or slightly down on stabilized same store revenue. Cap rates for self-storage properties should remain relatively consistent in the near term. While there is disruption in the overall economy, the need for self-storage space will continue and address changing needs by users.

CUSHMAN & WAKEFIELD

FOR MORE INFORMATION CONTACT:

MICHAEL A. MELE
Vice Chairman
+1 813 462 4220
mike.mele@cushwake.com

LUKE ELLIOTT
Executive Managing Director
+1 813 462 4212
luke.elliott@cushwake.com

CHRIS OWEN
Director, Florida Research
+1 407 541 4417
chris.owen@cushwake.com

RYAN CLEMONS
Senior Financial Analyst
+1 813 462 4218
ryan.clemons@cushwake.com

STEVEN PAUL
Financial Analyst
+1 813 462 4226
steven.paul@cushwake.com

Cushman & Wakefield
One Tampa City Center, Suite 3300
Tampa, Florida 33602
cushmanwakefield.com