

# Domestic Self-Storage Market

## PRICING AND PERFORMANCE TRENDS – 1ST HALF 2008

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**ALTHOUGH THE MAJORITY OF SELF-STORAGE FACILITIES CONTINUE TO PERFORM WELL, THERE ARE A FEW SELF-STORAGE MARKETS THAT ARE DEMONSTRATING SIGNS OF WEAKNESS.** Their weakness, however, has more to do with the errors made by a few overly enthusiastic and misinformed developers and investors than with market fundamentals.

The major question on the minds of most self-storage participants is: What happens to the self-storage industry if the U.S. economy slips into

a recession? A more telling question is: How much slower can the economy grow before self-storage owners start to see a significant, adverse impact on operating performances?

In April 2008, *Forbes* magazine identified five markets as "America's riskiest real estate markets" based on high rates of home foreclosures, job growth, and large inventories of homes for sale. Self Storage Data Services, Inc., (SSDS) studied these markets from an operating standpoint. As shown in Ex-

hibit DSS-1, self-storage facilities in these five markets are doing quite well with only one market, Sacramento, posting a 5.0% decline in collected rent over the past year.

Within the past 12 months, the amount of rent collected per occupied square foot in these "risky" markets increased an average of 4.0% after the cost of concessions were taken into consideration. Our analysis suggests that self-storage operations are stable, and may even be thriving, in markets like these despite the housing crisis and the U.S. economic slowdown.

Nevertheless, the current level of performance could be partially a function of the lag effect of the housing crisis, which suggests that a further slowdown in the economy will, at some point, negatively impact the performance of these, as well as many other self-storage markets. But for now, the underlying fundamentals remain strong in the majority of self-storage markets across America.

### INVESTMENT MARKET CONDITIONS

Transaction volume is down significantly. In addition, the distinction between Class-A facilities and "all others" is becoming more apparent. Investors are recognizing the importance of properly assessing risk based upon quality of construction, local market conditions, and location attributes. As a result, investment demand is strong for stabilized Class-A facilities, but only a limited number of facilities are available for purchase. However, brokers report a record number of listings of Class-B facilities, most of which they feel are

**Table DSS-1**  
**DOMESTIC SELF-STORAGE MARKET**  
First Half 2008

	FIRST HALF 2008	SECOND HALF 2007
<b>DISCOUNT RATE (IRR)<sup>a</sup></b>		
Range	9.25% – 11.25%	9.10% – 11.00%
Average	10.25%	10.00%
Change (Basis Points)		+ 25
<b>OVERALL CAP RATE (OAR)<sup>a</sup></b>		
Range	6.50% – 9.75%	6.50% – 9.50%
Average	8.00%	7.75%
Change (Basis Points)		+ 25
<b>RESIDUAL CAP RATE</b>		
Range	7.75% – 10.25%	7.50% – 10.25%
Average	9.00%	9.00%
Change (Basis Points)		0
<b>MARKET RENT CHANGE RATE<sup>b</sup></b>		
Range	3.00% – 3.75%	2.50% – 4.50%
Average	3.25%	3.25%
Change (Basis Points)		0
<b>EXPENSE CHANGE RATE<sup>b</sup></b>		
Range	3.00% – 5.00%	2.75% – 5.00%
Average	3.25%	3.75%
Change (Basis Points)		- 50
<b>AVERAGE MARKETING TIME<sup>c</sup></b>		
Range	1.50 – 3.00	1.50 – 2.50
Average	2.00	1.50
Change (%)		+ 33.33
a. Rate on unleveraged, all-cash transactions    b. Initial rate of change    c. In months		
Source: Self Storage Data Services, Inc.		

<b>Exhibit DSS-1</b>			
<b>AMERICA'S RISKIEST REAL ESTATE MARKETS*</b>			
Trends in Rent Collected per Occupied Square Foot			
MSA	1Q07	1Q08	% Change
Detroit	\$0.58	\$0.66	+ 14.0%
Denver	\$0.74	\$0.82	+ 11.0%
Cleveland	\$0.58	\$0.63	+ 9.0%
San Diego	\$1.09	\$1.08	- 1.0%
Sacramento	\$0.85	\$0.81	- 5.0%
<b>Average</b>	<b>\$0.77</b>	<b>\$0.80</b>	<b>+ 4.0%</b>
*As ranked by <i>Forbes</i> , April 2008 Source: Self Storage Data Services, Inc.			

not priced correctly in order to sell.

Fortunately, the narrow spread between anticipated development yields and current overall cap rates, together with limited capital for construction, will help to hold the lid on new supply.

#### Class-A Facilities

There is strong demand for Class-A facilities by the larger, sophisticated investors, such as REITs and large private operators. However, such properties have not been freely available in the marketplace. Still, several investors with an abundance of capital are well aware of the strength of this sector's fundamentals and are ready, able, and set to move when opportunities arise. The fact that overall cap rates have not been increasing as they have for most other property types demonstrates continued confidence in this sector on behalf of investors. Overall cap rates for Class-A facilities are shown in Table DSS-2.

#### Class-B Facilities

There is demand for Class-B facilities from investors who have cash. But, while more Class-B properties are available, fewer transactions are closing. Many, and perhaps most, of the investors looking to acquire Class-B facilities are waiting for sellers to discount their asking prices. Overall cap

rates for Class-B facilities are shown in Table DSS-2.

There are two types of sellers of Class-B facilities. First are the owners who are hoping to achieve an idealistic price based upon unrealistic overall cap rates and revenue projections. They are not highly motivated. Second are the owners who are highly motivated to sell because they are facing maturing loans and are not meeting investors' expectations.

The first group is the larger group. These sellers will probably not discount their asking prices because their facilities continue to perform well despite the slowing economy. These sellers do not have to sell.

The second, smaller group of sellers includes owners who were overzealous in their investment process and used overly optimistic projections in

forecasting their facility's future performance. While many of these owners blame oversupply issues for the poor performance of their investments, oversupply is not the problem in most cases. Rather, the problems stem from poor investment decisions. The question now is when will these sellers be motivated enough to reduce their asking prices to actual market value?

#### OPERATING PERFORMANCE

The self-storage industry has displayed tremendous resilience over the past several quarters, posting positive revenue growth in most individual markets through a period of weakening economic conditions and a prolonged housing market downturn. Although performances vary by market, supply and demand remain generally balanced throughout the industry.

Owners pushed up asking rental rates an average of 5.0% over the past 12 months and the median physical occupancy remains at 90.0%. After considering the cost of concessions, the amount of rent collected per occupied square foot – while down approximately 1.0% in the first quarter of 2008 compared to the same period last year - was generally flat over the past four quarters.

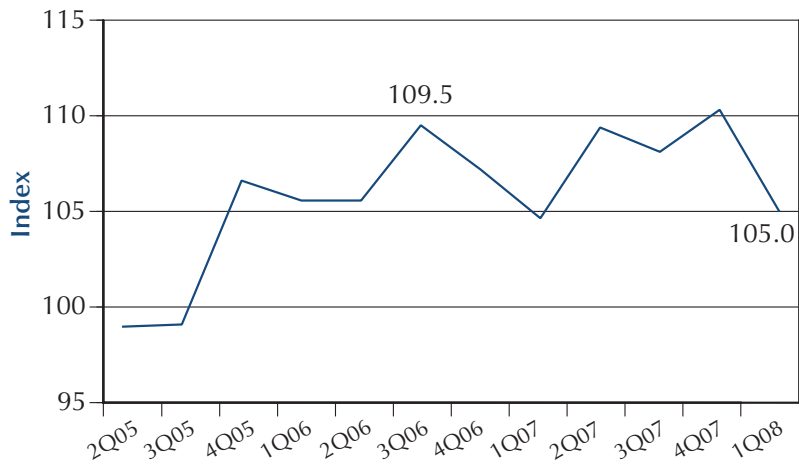
#### SELF-STORAGE PERFORMANCE INDEX®

The Self-Storage Performance Index (SSPI)® for the quarter ending March

<b>Table DSS-2</b>		
<b>OVERALL CAPITALIZATION RATES BY CLASSIFICATION</b>		
First Half 2008		
<b>CLASS-A SELF-STORAGE FACILITIES</b>		
<b>MINIMUM</b>	<b>MAXIMUM</b>	<b>AVERAGE</b>
6.50%	7.50%	7.20%
<b>CLASS-B AND CLASS-C SELF-STORAGE FACILITIES</b>		
<b>MINIMUM</b>	<b>MAXIMUM</b>	<b>AVERAGE</b>
7.75%	>10.00%	8.75% to 9.00%
Source: Self Storage Data Services, Inc.		

Chart DSS-1

**SELF-STORAGE PERFORMANCE INDEX (SSPI)®**  
2Q05 to 1Q08



Base: 4th Quarter 2003 = 100  
Source: Self Storage Data Services, Inc.

31, 2008 now stands at 105.0, down 5.0% from the prior quarter's restated index, but up nearly one-half of one percent (0.38%) from the same quarter a year earlier (see Chart DSS-1).

#### KEY INDICATORS

As shown in Table DSS-1, both the average discount rate and the average overall cap rate increased 25 basis points in the self-storage industry during the first half of 2008.

So long as the economy does not continue to deteriorate, a major upward movement in overall cap rates is not anticipated.

#### PERFORMANCE AT A GLANCE

##### Asking Rental Rates

As a result of having pushed asking rental rates 8.0% in the fourth quarter of 2007, owners were unable to increase rates again in the first quarter of 2008. As a result, asking rental rates remained flat in the first quarter of 2008 on a quarterly and annual basis.

##### Physical Unit Occupancy

Since owners held asking rental rates

flat, physical occupancy only dropped 0.3% in the first half of 2008; at which time median physical occupancy nationwide was 89.7%.

##### Rent Per Occupied Square Foot

Rent per occupied square foot is down 1.2% in the first quarter of 2008 compared to the same quarter last year.

##### Concessions

Today, approximately 60.0% of all facilities in the nation's largest 50 markets offer some type of concession, an increase of approximately 1.0% compared to the same period a year ago. The number of facilities offering concessions has been trending upward since the third quarter of 2006.

##### CONCLUSION

The self-storage industry's fundamentals remain strong from an operating standpoint in most areas of the country. Generally, additions to new supply are in check, and the effects of the slowing economy and the soft housing market have not adversely affected the industry – at least for now.

The current investment market is increasingly bifurcated between Class-A facilities and "all others." The limited number of Class-A facilities that come to market get good exposure and tend to sell quickly. For non-Class-A facilities, marketing times may be prolonged, and price discounting may not be as widespread as anticipated since the majority of Class-B facilities continue to be profitable.

At the same time, the gap is widening between the well-capitalized, sophisticated investors and the less-informed, under-capitalized investors. This gap begins with access to information and talent and is ultimately reflected in the difference in the long-term investment yields achieved by each group.

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**Charles R. Wilson & Associates, Inc.,** founded by Charles Ray Wilson, MAI, CRE, is now part of Integra Realty Resources, the largest national commercial real estate valuation and consulting firm in the United States. Integra Realty Resources' metro Los Angeles office continues to specialize in self-storage valuation nationwide.

In 1992, Charles Ray Wilson founded Self Storage Data Services, Inc., an independent research firm that maintains the nation's largest database of self-storage operating statistics. Mr. Wilson is a recognized leader in providing independent research on the self-storage industry. For more information about SSDS please visit their website at [www.ssdata.net](http://www.ssdata.net).