Mick Law, P.C. 2nd Quarter 2019 Storage Industry Report

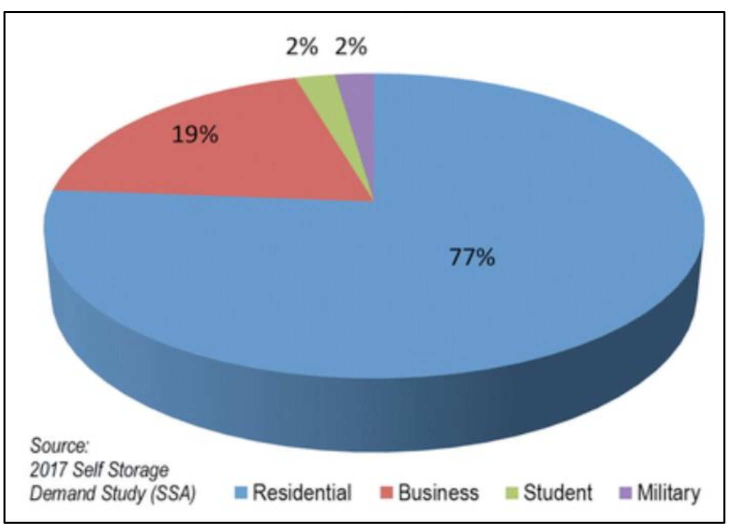
David M. Sengstock, Esq, Director
Alan Lincoln, MBA, CCIM
www.micklawpc.com

Industry Overview

According to the 2019 Self-Storage Almanac, there are approximately 45,547 self-storage facilities in the nation totaling over 22.0 million units. In total, there are nearly 1.7 billion square feet ("SF") of self-storage space, or approximately 5.4 rentable SF of self-storage for every person living in the U.S. The average self-storage property measures 37,523 SF. In comparison to historical standards, today's self-storage facilities are larger, however are equipped with a fewer number of storage units. This would indicate that developers are building a number of larger storage units within their projects and existing projects may be converting units to meet the demands of their customers.

Self-storage customers typically fall into one of four categories, namely residential, business or commercial, military and students. Residential is by far the greatest category of renter, with approximately 77% of all self-storage units occupied by residential renters. Although 68% of all residential renters live in a single-family home, a number of life changes including a relocation, change in family status, the birth or death of a family member, or a household remodeling project can attract them towards self-storage rental. In addition, many apartment or condominium renters do not have enough storage space where they live and are seeking a longer-term storage solution. Commercial tenants make up an increasingly larger portion of self-storage. At 19% of total units, most commercial tenants are small business owners or contractors who need to store equipment or inventory off-site. Military and defense spending and relocations continue to be a driver of self-storage demand with 2.0% of total units leased to military personnel. Many military renters are enlisted servicemen and women who need a storage facility to house their belongings while away in training or on deployment. Finally, approximately 2.0% of the nation's self-storage renters are students. Below is a breakdown of self-storage customers:

Average Tenant Mix



Texas continues its long-term reign as the state with the most self-storage facilities in the country. In 2018, this state alone was home to 4,904 self-storage projects totaling 207,150,002 SF, or approximately 12.1% of the nation's self-storage. By contrast the District of Columbia has the fewest storage properties with just 19 facilities in operation with 1,211,000 SF of space. The District of Columbia also has the fewest number of SF/person at 1.84, followed closely by New York, Hawaii and Maine, all with less than 3.0 SF/person. On a per capita basis, residents of Idaho currently have access to the most SF of storage in the nation; the state boasts 10.76 rentable SF of self-storage per person.

Looking at the data on a smaller scale by Metropolitan Statistical Area ("MSA"), the Dallas-Fort Worth-Arlington MSA has the greatest number of facilities, with 1,198 operating self-storage facilities within the Dallas-Fort Worth-Arlington MSA boundaries for a total of 58.9 million SF of space or approximately 8.47 SF/person. In terms of per capita rentable square footage, the Daphne-Fairhope-Foley, Alabama MSA tops the list with 12.84 SF of storage space per person.

Top Operators

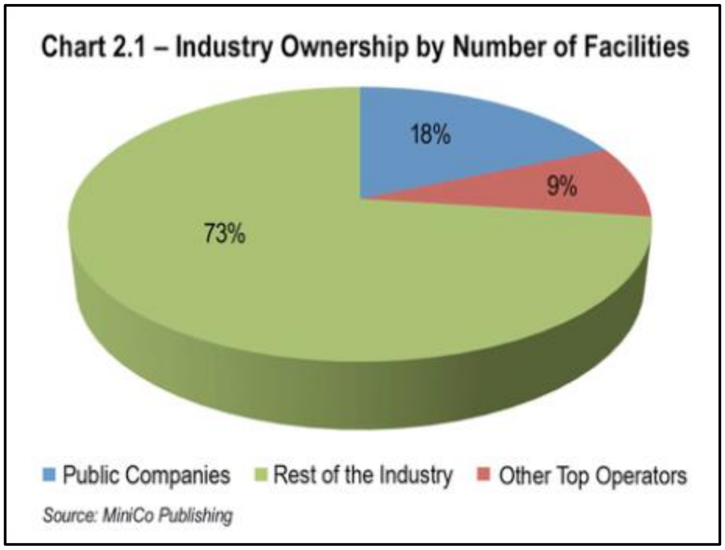
Although the self-storage industry is dominated by small, private operators, the top six operators within the self-storage industry are all public companies, the largest of which is Public Storage. Public Storage (NYSE:PSA) was founded in 1972 and today remains the dominant force in the industry. With 2,630 facilities under ownership totaling 173 million SF, the company owns and operates approximately 5.8% of all storage facilities in the nation. Distinct from its competitors, the company does not offer third-party management services of non-owned facilities. Public Storage has continued efforts to acquire additional units.

A summary of the 10 largest self-storage operators is outlined below:

Ranking	Company Name	Number of Facilities	Square Feet	Number of Units	Market Share
1	Public Storage	2630	173,000,000	1,535,000	10.13%
2	Extra Space Storage	1568	119,275,324	763,561	6.98%
3	CubeSmart	1048	70,900,000	405,000	4.15%
4	U-Haul International	1580	58,038,818	375,164	3.40%
5	National Storage Affiliates	819	52,300,000	340,000	3.06%
6	Life Storage	723	50,810,000	424,527	2.97%
7	StorageMart	204	13,221,027	71,134	0.77%
8	StorQuest	151	10,500,761	69,542	0.61%
9	SmartStop Asset Management	135	9,976,000	74,160	0.58%
10	Metro Storage	142	9,600,000	81,000	0.56%

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%. The industry has hundreds of mid-sized 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.

There are six public corporations operating in the industry: Public Storage; Extra Space Storage; Cube-Smart; National Storage Affiliates Trust; Life Storage, Inc.; and U-Haul International. Five of the public companies are organized as REITs while Phoenix, Arizona based U-Haul International is publicly traded, however, is not organized as a REIT. Together these public companies own 18% of the self-storage facilities in the nation. A chart outlining the ownership of these public companies can be found below:



Self-storage operations in the top 25 to 50 markets are controlled primarily by large, sophisticated companies, giving them a greater percentage of ownership in these markets compared to self-storage across all markets in the U.S. This can be attributable to very different dynamics. First, the larger operators prefer these metro areas because they are able to get the highest rents in the market, often coupled with higher occupancy rates. Second, because the larger operators are typically better capitalized, they can afford to pay higher land costs to develop and higher acquisition prices to purchase facilities in these markets.

Current Trends

Strategies for best operating a self-storage business have evolved over the years as the industry has grown and matured. In the earliest days of the self-storage sector, most facilities were small, independent businesses run by sole proprietors. Today, mom and pop operations remain common, but the industry has shifted more towards 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, slightly more than 10% of storage facilities are managed by the owner.

The average self-storage facility 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% 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% of operators sell insurance at their facilities, a 12% increase over 2017. Car washes are becoming a common attraction at self-storage facilities. Although more common with high-service facilities including RV, camper or boat storage facilities, 6.0% of facilities now report an on-site car wash.

National Market Fundamentals

According to REIS.com, as of the second quarter of 2019 (the most recent report as of the date of this opinion) the national vacancy rate was 12.6%, down 100 basis points over the first-quarter 2019 vacancy rate, however, up 130 basis points over the level found one year prior, and up 340 basis points from the cycle-low vacancy rate of 9.2%, found during the 2nd quarter of 2016. Within its 2019 Self-Storage US Investment Forecast, Marcus and Millichap forecast the self-storage industry will continue to benefit from long-term demographics including the aging of the millennial generation, who prefer rented living accommodations and now make up approximately 1/3 of all non-commercial renters. Additionally, the Marcus and Millichap report notes that subdued construction earlier in the cycle has resulted in pent-up demand for new storage facilities in many metro areas with the greatest potential growth in secondary and tertiary markets.

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 100 basis point decline in vacancy rate just within the past quarter.

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, however, new development will out-pace demand in 2019. The forecast from REIS calls for a vacancy rate of 14.3% by year-end 2019 with a stabilization thereafter, and the vacancy rate dropping back under 13.0% throughout the five-year forecast horizon.

The average monthly rental rates for the five most common unit sizes are outlined below:

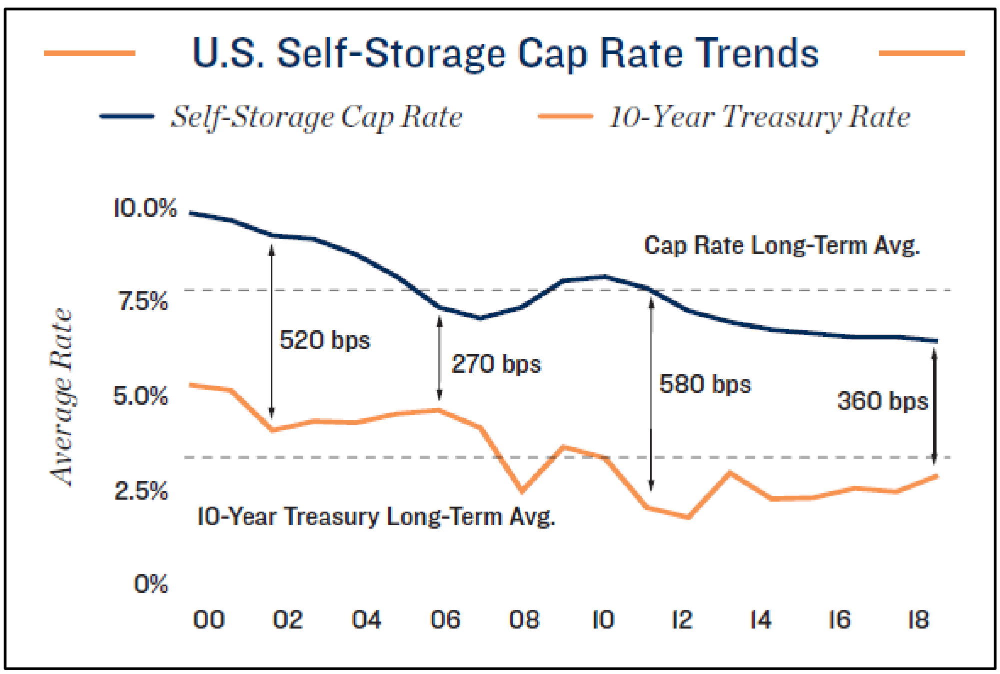
Unit Type	**5X5**	**5X10**	**10X10**	**10X15**	**10X20**
Non Climate Controlled	$58.44	$80.71	$123.55	$159.81	$192.48
Climate Controlled	$70.46	$99.70	$155.00	$201.41	$253.28

On average, asking rental rates were up 1.2% during 2017 and another .7% during 2018. The forecast is for continued gradual rental rate increases, reaching approximately 2.0% by 2022 and beyond.

Investment Market

According to the Marcus and Millichap 2019 Self-Storage US Investment Outlook, 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 to near $100/SF. For recently traded assets, the average initial cap rate is in mid-six percent range, down from the low-eight percent range of 2010.

Overall, higher sales prices are enticing owners to bring their assets to market, and amid the recent decline in interest rates, spreads remain strong compared with other property types. In order to maintain yield, many REITS and private investors 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, however, many capital providers have become increasingly selective as they re-assess risk. A summary of the historical average cap rate over the past several years and a comparison to US Treasury Rates may be found below:



Conclusion

As cap rates have trended down in the storage industry, tracking cap rates in other commercial real estate asset classes, many self-storage investors have moved to secondary and tertiary markets to chase yield and spread. Further, investors with holdings in other asset classes have moved into the self-storage industry to meet return thresholds, placing additional downward pressure on self-storage cap rates. We believe that the cap rate trend may have reached a valuation plateau, subject of course to the actions of the Federal Reserve on the short-end of the yield curve and the motivations of bond market investors to push yields down on longer-term treasuries (assuming of course constant spreads). With asking rents currently below and projected to remain below broader inflation numbers, and vacancy rates on a national basis starting a reversion to the longer-term average in the low double-digits, future upside will be limited within the industry. However, we of course acknowledge that underwriting real estate is a local exercise and value can be created through special situations, development, mezz structures and the like. In our opinion these strategies are the ones to pursue in the storage segment of the commercial real estate industry for the foreseeable future.