BEYOND THE GLOBAL HEALTH CRISIS

Marcus & Millichap

SPECIAL REPORT SELF-STORAGE THIRD QUARTER 2020

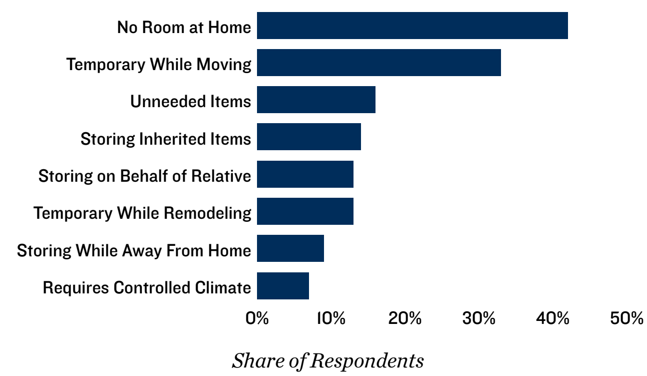
Self-Storage Demonstrates Durability Through the Health Crisis; Positive Long-Term Demand Drivers Remain Intact

Physical distancing accelerates automation, aids demand. While self-storage businesses were classified as essential and were able to stay open during lockdowns, many still recorded subdued leasing velocity in March and April. The pace of move-ins has since improved, aided by the expansion of online rental platforms and remote access systems such as electronic locks that minimize personal interaction. The shift to remote work and learning as well as physical distancing at restaurants and businesses likely contributed to leasing activity. At the same time, the number of existing tenants moving out of units remained well below historical levels. Together these trends are driving notable changes in property performance.

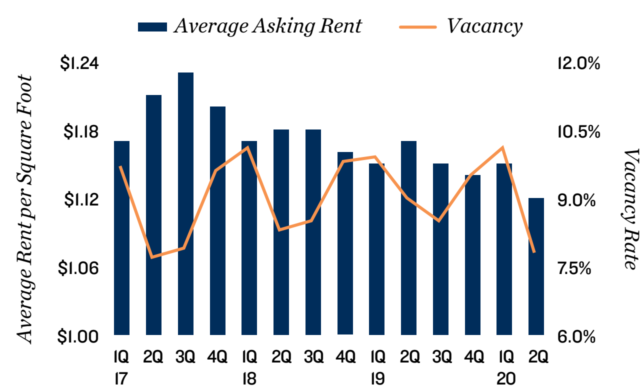
Sheltering pushes vacancy and rents down through June. Self-storage vacancy contracted sharply in the second quarter as the decrease in move-outs exceeded any disruption to move-ins. Between March and June, the national rate fell 230 basis points to 7.8 percent, a three-year low. Despite the drop in vacancy, operators have been reluctant to raise rents during the pandemic, with competition for tenants at recently built properties in particular applying downward pressure to asking rates. Between the first and second quarters, the national average fell 2.6 percent to $1.12 per square foot, its lowest level in more than four years. Both asking rent for new tenants and effective rent for existing occupants began to increase in July, however, reflecting an uptick in move-ins.

Household consolidation, relocation may drive new storage use. The initial wave of federal unemployment benefits expired in July, and while an executive order aims to extend support, without congressional action the added fiscal resources have already begun to deplete. This will impair the financial health of some self-storage renters and place downward pressure on operations. The negative impact to property performance will, however, likely be partially offset by some other countercyclical drivers. As more people move in with family or friends to reduce living expenses, the household consolidation should increase storage needs. Other pandemic-motivated relocations may create demand as well. Months of sequestration are propelling some people to migrate to larger living spaces in lower-cost neighborhoods or metros. As changing residences is a major driver of self-storage use normally, this trend could bode well for storage properties in popular relocation destinations, including much of the Sunbelt.

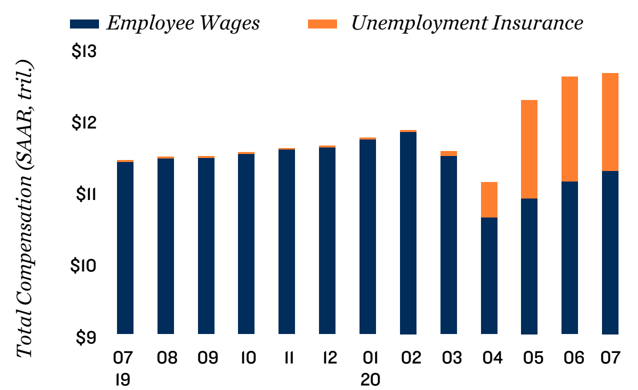
Top Reasons for Renting a Storage Unit*



Rent & Vacancy Face Downward Pressure



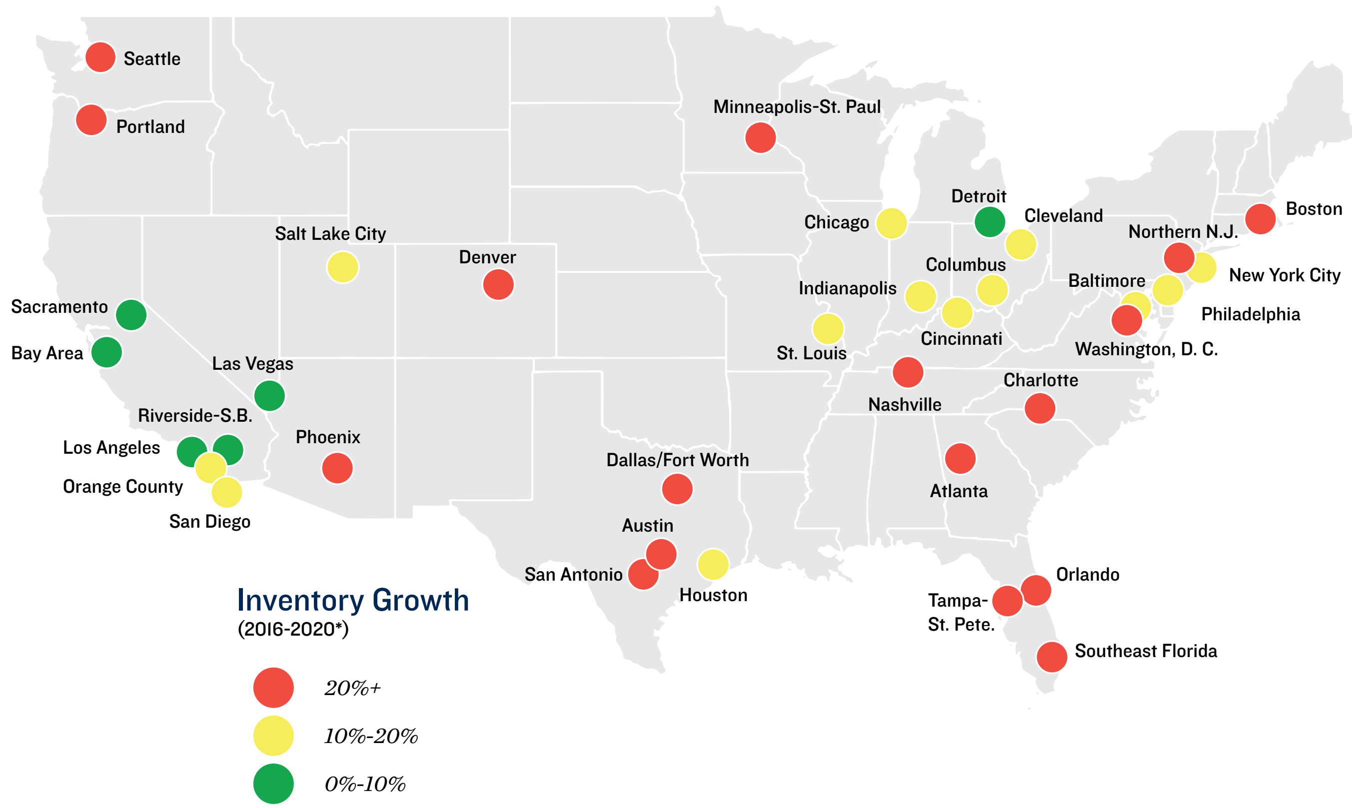
Unemployment Benefits Heavily Relied On in 2Q



* Unit may be rented for more than one reason; values do not add up to 100 percent.

Sources: Marcus & Millichap Research Services; BEA; SSA; Union Realtime; Yardi Matrix

Health Crisis Delays Construction Projects After Record Development Period; Change in Inventory: 2016-2020*



Record construction leaves imprint on self-storage. Before the health crisis presented new challenges, the self-storage sector was contending with concerns stemming from recent record development activity. Since 2016 about 244 million square feet of self-storage space has opened, a 17 percent increase in inventory. Dallas/Fort Worth, Houston and Denver had the most square footage come online, while Nashville, Minneapolis-St. Paul and Portland recorded the largest rate of growth in inventory. The compressed time frame in which deliveries were made in these and other metros created short-term oversupply concerns in some submarkets. Properties built within the last few years are competing for tenants with existing and other recently completed facilities, weighing on occupancy and rent growth in the short term. Looking forward, the outlook is much more favorable. The reason many markets welcomed large concentrations of arrivals was because they also reported above-average population growth that will raise demand over time. The future construction pipeline was also beginning to moderate even before the spread of the coronavirus, with initially planned 2020 openings down 20 percent from 2019.

Health crisis tempers development but complicates leasing. Precautions taken to stop the spread of COVID-19 have caused the temporary closure of construction sites and impeded the traditional building process with new safety practices. These changes have led to development delays that will likely diminish the 2020 self-storage construction pipeline from its initial 2020 forecast. Fewer deliveries will reduce the amount of competition some properties are facing in the marketplace, granting more time for demand to catch up to the recent rapid supply growth. However, other disruptions caused by the health crisis may offset any benefits earned from these delays. While stabilized properties are supported by sizable bases of established renters, more recent completions are striving to find tenants during a time when personal interaction is more difficult. This is especially true if there are multiple facilities still in lease-up within a 3 to 5 mile radius of one another. The longer these properties take to stabilize, the greater the risk of default on development-related debt obligations. A wave of potential sequestration-motivated relocations could lift demand in certain areas later in the year, aiding some of these facilities.

** Through second quarter*
Sources: Marcus & Millichap Research Services; Yardi Matrix

Region	Market	2Q Trailing 12 Month Completions	Y-O-Y Inventory Change	2Q Vacancy Rate	Q-O-Q* Basis Point Change	2Q Average Asking Rent	Q-O-Q* Rent Change
Northeast	Baltimore	680,100	4.3%	7.5%	-180	$1.23	-3.1%
	Boston	1,570,900	6.2%	8.2%	-200	$1.40	-2.8%
	New York City	1,031,700	4.1%	7.6%	-130	$2.48	-3.1%
	Philadelphia	1,034,100	3.8%	7.1%	-90	$1.17	-3.3%
	Washington, D.C.	1,344,600	4.3%	6.5%	-180	$1.35	-4.9%
South	Atlanta	1,833,800	4.5%	7.8%	-140	$0.92	-4.2%
	Nashville	1,141,800	8.6%	7.0%	-300	$0.98	-1.0%
	Orlando	2,067,000	8.5%	9.1%	-140	$0.96	-4.0%
	Southeast Florida	2,458,700	5.8%	7.3%	-10	$1.26	-6.7%
	Tampa-St. Petersburg	1,479,100	5.4%	8.8%	-90	$1.01	-3.8%
Midwest	Chicago	1,921,700	3.7%	7.5%	-70	$0.97	-3.0%
	Cincinnati	342,400	3.2%	6.4%	-90	$0.87	-1.1%
	Cleveland	341,700	2.5%	8.8%	-120	$0.92	-2.1%
	Columbus	187,400	1.5%	5.9%	-250	$0.84	-1.2%
	Indianapolis	827,100	5.1%	6.9%	-110	$0.81	-2.4%
	St. Louis	559,800	3.9%	6.9%	-420	$0.89	0.0%
Texas	Austin	1,196,500	5.9%	7.7%	-150	$0.94	-2.1%
	Dallas/Fort Worth	2,868,300	4.1%	7.2%	-100	$0.91	-2.2%
	Houston	1,186,700	1.7%	8.5%	-70	$0.81	-3.6%
	San Antonio	674,200	3.2%	6.6%	-100	$0.94	-1.1%
Mountain	Denver	900,400	3.0%	6.5%	-270	$1.14	-0.9%
	Phoenix	2,894,100	8.5%	5.3%	-200	$1.04	0.0%
	Salt Lake City	756,800	3.1%	4.8%	-480	$0.95	0.0%
West	Bay Area	509,100	1.1%	5.4%	-150	$1.82	-3.2%
	Los Angeles	915,300	2.7%	6.8%	-50	$1.86	-4.1%
	Riverside-San Bernardino	369,400	1.1%	5.5%	-120	$1.11	-2.6%
	San Diego	690,900	3.4%	5.8%	20	$1.54	-0.6%
	Seattle-Tacoma	2,342,900	7.6%	5.9%	-150	$1.45	-2.7%
	United States	62,203,700	3.9%	7.8%	-230	$1.12	-2.6%

** Quarter-over-quarter*

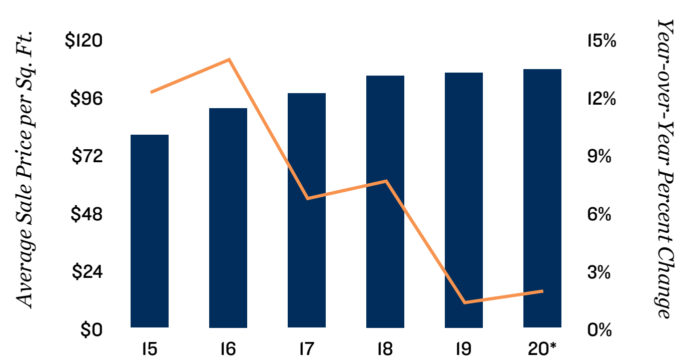
Sources: Marcus & Millichap Research Services; Union Realtime; Yardi Matrix

Forward-Looking Factors Draw Investor Interest Despite Short-Term Disruptions

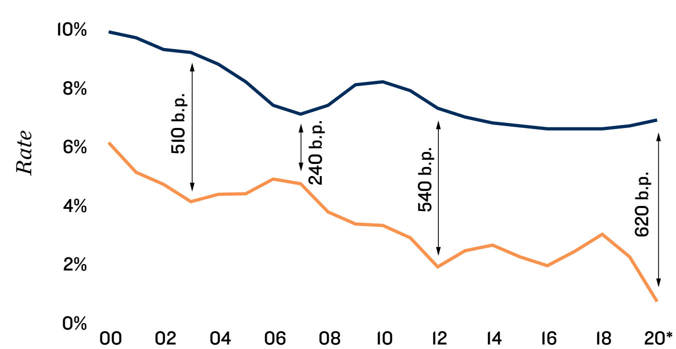
Self-storage investment activity aligns with market. General uncertainty and logistical complications substantially reduced self-storage transaction velocity in the second quarter, as with all other commercial property types. While numerous facilities changed hands prior to the pandemic, sales activity in the second quarter fell more than 65 percent compared with the same period last year. Despite these disruptions, the property type's performance durability, aided by counter-cyclical rental drivers including household consolidation and population migration, have reinforced investor interest. Future self-storage transaction activity is supported by a growing yield premium between a rising average self-storage cap rate and drastically cut interest rates. More commercial property investors are also shifting over to self-storage in a flight to safety prompted by greater turbulence in other segments of the investment landscape.

Sales pricing bifurcates between stabilized and new assets. After an initial assessment period, more lenders, including banks, credit unions, and CMBS sources, are financing self-storage transactions. Terms and conditions vary by individual property, although more concern is forming around facilities built since 2016. Some of these assets are underperforming other nearby older and more established properties. Greater competition from new supply, paired with complications from the coronavirus, are extending the stabilization process and applying downward pressure to asking rents. Some assets may fail to meet income expectations and by relation construction-related debt obligations. This potential shortfall is weighing on sales prices for such properties. Established facilities, in contrast, are facing less downward pricing pressure. At a national level, the average sale price continued to advance on a rolling 12-month basis through June, although the pace is subdued compared with past years.

Sales Price Appreciation Moderates



Yield Premium Hits 20-Year High



* Through second quarter
Cap rates are trailing 12-month averages.
Sources: Marcus & Millichap Research Services; CoStar Group, Inc.

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Sources: Marcus & Millichap Research Services; CoStar Group, Inc.; Federal Reserve Bank of St. Louis; Self Storage Association 2020 Demand Study; Real Capital Analytics; U.S. Census Bureau; Union Realtime; Yardi Matrix