

Self-Storage Buoyant Through Health Crisis; Demand Drivers at Point of Transition

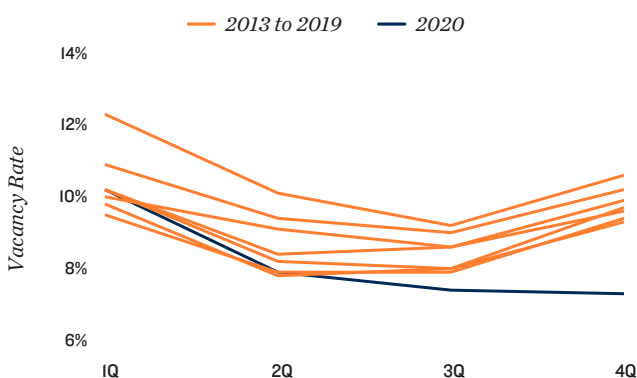
Self-storage proves durable through pandemic. Although not exempt to the challenges posed by the health crisis, self-storage properties have demonstrated resilience over the past 16 months. Before the pandemic arrived, the sector was contending with the detrimental effects of record construction activity on fundamentals, especially rents. The sudden shift to remote learning and working, as well as a greater emphasis on outdoor activities and migration to less dense areas, created new needs for storage units. An increase in move-ins, paired with fewer move-outs, pushed the national vacancy rate down to a multidecade low of 7.2 percent last year. The drop in availability, aided by a slight slowdown in deliveries, applied upward pressure to asking rents on a countrywide level for the first time since late 2017. These performance fundamentals have continued to improve through the first several months of 2021, even as the dangers of the health crisis abate and life returns to a more typical cadence.

Economy recovers as infections fall. After shutdowns last year, the economy is making significant positive progress as vaccination rates climb. Most states have largely reopened, providing more avenues for previously sequestered households to allocate their pent-up dollars. The combined value of both personal savings accounts and money market funds has risen by over \$4 trillion since the start of the health crisis, which has translated into higher overall spending as the economy reopens. Core retail sales topped \$430 billion in April, 15 percent above the pre-pandemic level. While e-commerce captures a greater share of these dollars, consumers are also venturing out more, fueling job creation across a range of sectors, including retail trade, leisure, and hospitality. These trends will in turn foster new household formation in the long term. All of these factors drive new consumer activity that ultimately leads to more items needing to be stored.

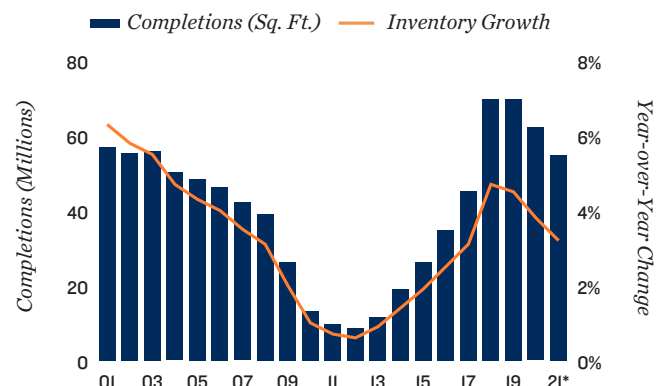
Improving economy to aid sector as some short-term needs end. As the economy reopens, some pandemic-specific demand drivers for self-storage are dissipating. College students who had placed belongings into storage when campuses closed will retrieve their supplies as they return to classrooms. Similarly, a shift back into offices may free up space at home. The need to rent a storage unit during a relocation, such as the recent migration trend from urban to suburban areas, will continue, however. While accelerated by the health crisis, this population shift is partially due to the aging of the millennial population. As the broader economy recovers, other traditional demand drivers will return as well. Open offices will again prompt people to relocate for work, while an overall decline in unemployment will foster new household formation and consumer spending that eventually drives storage use. During this period of transition from short- to long-term demand drivers, property fundamental improvement may lose momentum. Both vacancies and rents are expected to be positive over the next cycle, though, as development activity continues to moderate.

Slowing supply growth to help property performance. Total completions expected for 2021 will fall below the 60 million-square-foot mark for the first time in three years. The relative slowdown will help lower competition for tenants among new projects. The composition of the development pipeline is also shifting to favor markets with higher absorption potential. Several of the metros where inventories are slated to grow the most in 2021 have trailed in construction in recent years, such as New York City, Sacramento and Las Vegas, or are recording robust population growth, including Phoenix and southeast Florida. Unburdened from lockdowns, recently built facilities are expected to lease-up more quickly moving forward, lowering the downward pressure on rents as concession use contracts.

Pandemic Demand Disrupts Seasonality



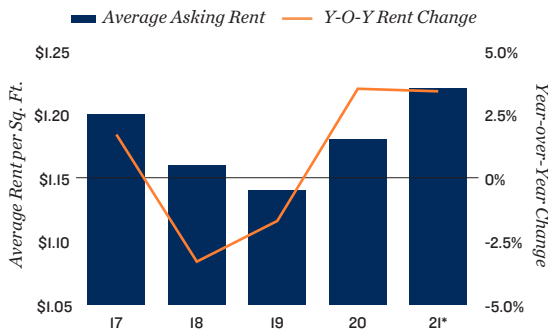
Construction Pace Continues to Slow



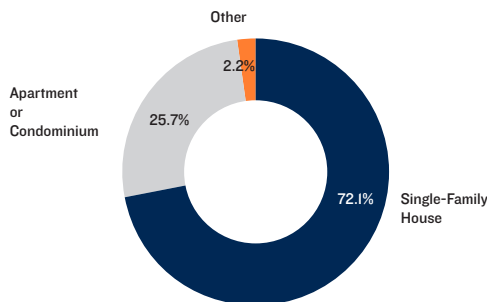
* Forecast

Sources: Radius+; Yardi Matrix

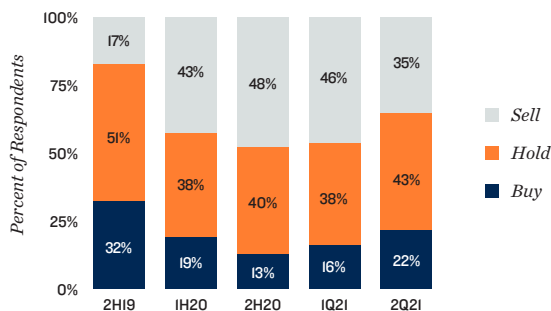
Rent Growth Returns



Self-Storage Renters by Dwelling



Buy/Hold/Sell Sentiment



Investors Expect Costs to Climb



71%
Operating Expenses



76%
Property Taxes

Population Migration Key to Self-Storage Outlook

Aging millennials leverage self-storage during relocations. By encouraging people to stay at home, pandemic health guidelines accentuated some of the advantages of living in a suburban setting. This prompted more households that were in urban areas to move, a trend that will continue after the health crisis as the young adult population ages. The median age of a millennial is 30, with the oldest of the cohort now entering their 40s. Family formation often occurs in that age group. In the years ahead, as more millennial households age and expand, they will seek larger living accommodations, which are often situated in less costly suburban neighborhoods, including those in other metros. The relocation from one market to another has been well documented over the past 16 months and has created new demand for self-storage space, as changing a residence is the second most common reason for renting a storage unit. Demand from suburban relocations is likely to continue over the next several years as the younger half of the millennial generation exits their 20s. Additionally, those who have already made the move are also now more likely to need self-storage space again in the future.

Current renter profiles suggest self-storage use may continue after move. Renters of storage units who relocate from a smaller downtown apartment to a larger suburban dwelling may not cease self-storage use. Even though many single-family homes have access to additional storage space in the form of garages, basements and attics, over 72 percent of all current non-business self-storage renters live in such a residence. As previous generations have aged and expanded their living situations, they have continued to need separate storage space. That dynamic may manifest among the aging millennial generation. At the same time, demand will continue for self-storage units near urbanized residential areas. A return to in-person work will draw many professionals, including recent college graduates, to downtown areas for new job opportunities. Some urban rentals may also be taken up by older, downsizing households. Together, these demographic dynamics are set to support the self-storage sector over the long term.

Opinions From Investors Reveal Bullish Sentiments

Majority of investors anticipate improving rents, higher prices. A June survey of self-storage investors reveals a favorable outlook for the sector. About 85 percent of respondents anticipate vacancy to fall or remain stable over the next 12 months, while 73 percent of investors expect the average asking rent to rise. Only 4 percent of respondents predict a rent decline. Even if the national vacancy rate holds flat, as about half of investors expect, the rapid contraction of unit availability since 2019 has been more than sufficient to renew upward movement in marketed rents. These favorable performance expectations are also reflected in a positive outlook for property values and cap rates. Over 90 percent of investors expect sales prices to hold or climb in 2021, while 81 percent of respondents anticipate cap rates to stay the same or contract. Since 2017 the average sale price has increased 18 percent, while the mean cap rate has stayed in the mid-6 percent zone, supporting this outlook. There are some concerns on the horizon, however. Strong price gains will translate into higher property taxes after a facility's next appraisal, and operating costs are also on the rise, including from digital advertising. Nearly three-quarters of investors expect these issues to become more prevalent going forward.

* Forecast
Sources: 2021 Self-Storage Almanac; WMRE/Marcus & Millichap Self-Storage Investor Survey; Yardi Matrix

Recovering Consumer Base, Easing Construction Pave Way for Vacancy, Rent Improvements

2021 Forecast

U.S. CONSTRUCTION

55 million square feet completed

- Completions continue to recede from the roughly 70 million square feet delivered in 2018 and again in 2019. Among metros, Dallas-Fort Worth and New York City lead development, with more than 2 million square feet slated to arrive in each locale before the end of the year.



U.S. VACANCY

20 basis point decrease Y-O-Y

- The health crisis disrupted normal seasonal rental patterns, pushing the overall vacancy rate down to a more-than-15-year low in 2020. Availability will continue to contract this year, dropping by a more modest margin to 7.0 percent as the economic recovery sustains storage needs.



U.S. RENT

3.4% increase Y-O-Y

- After undoing two years of rent declines in 2020, the average asking rate for a standard 10-foot by 10-foot unit will continue to climb in 2021, reaching \$1.22 per square foot. Before this year, the average rent was last above the \$1.20 threshold in mid-2017.



U.S. RENT (CLIMATE-CONTROLLED)

3.7% increase Y-O-Y

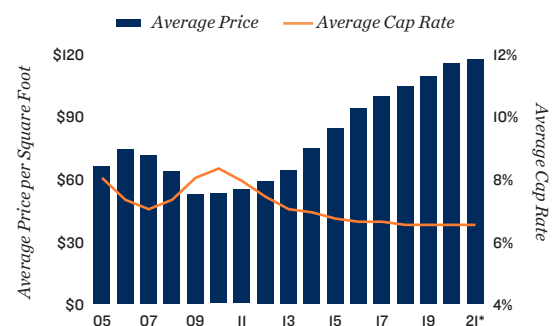
- After falling by a greater degree between 2017 and 2019, the average asking rent for a 10-foot by 10-foot climate-controlled unit will rise by a slightly faster rate than that of a standard unit in 2021. The average climate-controlled rent will improve to \$1.38 per square foot by year end.



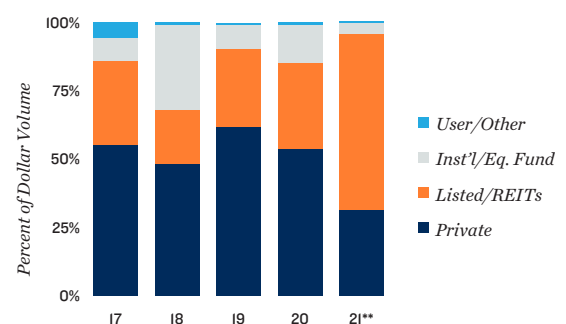
2021 INVESTMENT OUTLOOK

- **Favorable outlook fosters rising sale prices as cap rates generally hold.** Trading activity only dipped 5 percent in 2020 following a record year for transactions in 2019, with investor sentiment buoyed by improving property performance. Competition for listings is applying momentum to sale prices, which have already improved 6 percent year over year for the 12-month period ending in March to an average of \$117 per square foot. The mean cap rate has so far held in the mid-6 percent zone, but downward pressure is mounting. Interest for high-quality assets in growing submarkets has led to cap rates of under 4 percent for some recent trades, which will likely draw the average return down in the coming months.
- **Buyers initially stayed away from heavily shutdown markets.** Stringent and prolonged lockdowns in many of the major West Coast and Northeast metros reduced buyer interest in these areas last year, while other regions of the country recorded similar or increased transaction levels. Favorable population dynamics and relatively low business costs are drawing investors to the Southeast and Southwest, comprising more than half of all trades completed last year.
- **Institutions still targeting gateway cities.** Although hard hit by the pandemic, the Bay Area, New York City, and Los Angeles are still recording institutional self-storage investment at sale prices over \$20 million. A low level of inventory relative to population support positive long-term outlooks for these and similar metros, drawing buyers who can afford the high entry costs. Secondary and tertiary markets meanwhile continue to draw a large number of smaller investor groups and private buyers, aided by lower sales prices and stronger household formation.

Sales Trends



Buyer Composition



* Through 1Q

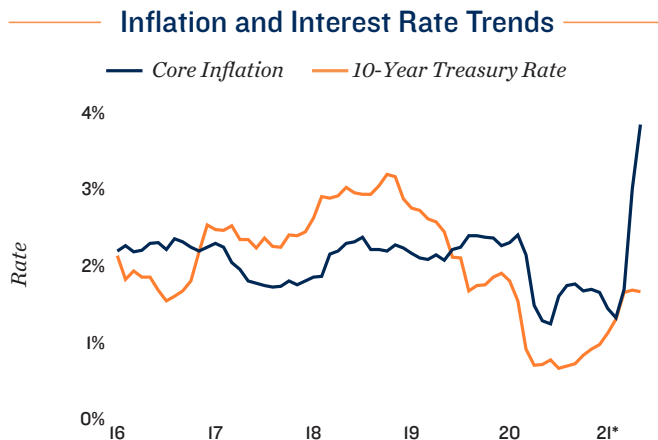
** Year to date through May

Buyer composition for sales \$2.5 million and greater, domestic capital sources
Sources: CoStar Group, Inc.; Real Capital Analytics

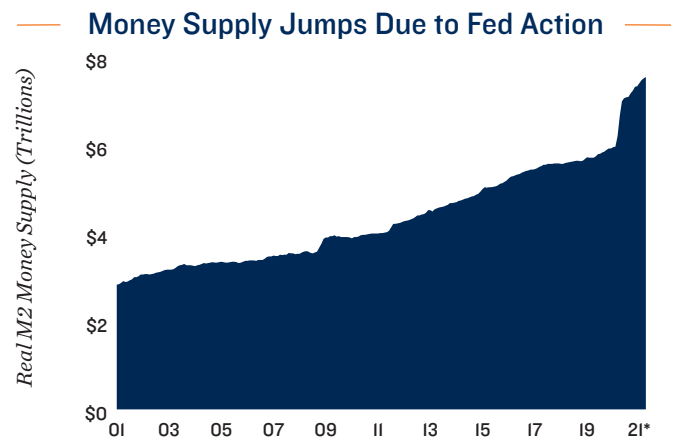
Capital Market Operations Largely Resume; Inflation Concerns Becoming More Apparent

Fed positions for temporary higher inflation period. Applying lessons learned from the global financial crisis, Congress and the Federal Reserve acted swiftly to preserve market liquidity and support borrowers amid the pandemic last year. As U.S. infections recede and the economy reopens, attention is shifting to the potential longer-term ramifications of these actions. The rapid increase in money supply from multiple stimulus provisions paired with low interest rates and disrupted supply chains has led to higher inflation, with core CPI climbing 3.8 percent annually in May. While above earlier expectations, the Federal Open Market Committee (FOMC) still considers this a transitory concern and intends to allow inflation to stay above the traditional 2 percent growth target for longer than it has in the past. The Fed also expects to keep the overnight lending rate low for the near future, citing still-high unemployment as one reason to hold off. More committee members are now open to the prospect of raising rates in 2023, however. Current quantitative easing practices will also remain in effect for the time being. The FOMC will wait for more substantial economic progress before tapering asset purchases, although some pandemic period programs have already expired.

Strong self-storage property performance draws attention of returning lenders. Following significant disruptions last year, the majority of lenders are now active and anticipating larger volume after 2020's slowdown. Sentiment is improving, aided by a 10-year Treasury rate in the 1.5 percent range and greater population mobility, which will help properties in commercial and travel hubs that were disproportionately affected by lockdowns. Lenders are nevertheless favoring borrowers with whom they have an established and positive relationship. A borrower's credit worthiness and track record bear considerable weight when accessing capital, as does recent property performance, including rent collections. More opportunities are available for assets that demonstrated durability during the pandemic or are now in a strong recovery position. The strong performance of self-storage properties during the pandemic have distinguished these properties among lenders. Capital is readily available for the refinancing or sale of existing properties from banks, credit unions, as well as life insurance companies, and are involved in CMBS securitizations. Financing for new construction projects may be more difficult depending on the location of the property and profile of the borrower. Overall, while lending volume is not anticipated to recover to 2019 levels, the impact of the health crisis on capital availability is expected to be less severe than that of the global financial crisis. The external nature of the health problem and critical efforts taken by Congress and the Federal Reserve have maintained and are improving liquidity in the market.



*Through May
Sources: BLS; Federal Reserve



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