



SELF STORAGE SALES NETWORK

Market Monitor

“America’s Premier Self Storage Brokers”

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Self Storage 2007: A Market Overview

by Michael L. McCune

It Is The Best of Times!

Charles Dickens began A Tale of Two Cities with these words, but then added the caveat, “and the worst of times.” I have no such disclaimer on the status of the self storage real estate market today. Without qualification, the market today is simply the best for owners and buyers at any time in the existence of our business. Interest rates are low, lenders are aggressive, buyers can earn a very competitive return when purchasing facilities, there are large institutional investors buying self storage, and values of properties are at all-time highs. While there is no qualification of any kind on this opinion, it also carries no warranty in the future.

The Last Three Years

Many self storage owners may have been casually aware of the changes in the commercial real estate world, but they may not have noticed the seismic changes that were taking place in recent years. Table I below will give you an idea of how a typical project’s value has been changed by the real estate market over the last three years. You’ll note that the property generated exactly the same income in each year; it is only the change in the market cap rate that has affected the value of the project. The change is even more dramatic when you consider the increase in the equity value.

Table I

| | Scenario 1 | Scenario 2 | Scenario 3 | Scenario 4 |
|-------------|-------------|-------------|------------------|------------------|
| NOI | \$200,000 | \$212,000 | \$212,000 | \$212,000 |
| Cap Rate | 7.5% | 7.5% | 8.5% | 9.5% |
| Value | \$2,660,000 | \$2,826,000 | \$2,494,000 | \$2,231,000 |
| Equity* | \$1,073,000 | \$1,239,000 | \$907,000 | \$644,000 |
| Equity Loss | N/A | N/A | \$332,000 27% | \$595,000 48% |

Source:

Self Storage Data Services, Inc. – Pasadena, CA Copyrighted

* Assumes 75% loan

Some Interesting Conclusions:

- 26% increase in **Value** solely because of change in Cap Rate
- Increase in **Equity: 100%+** increase
- Loan to Value Ratio Change: was **75%**, now **59%**

Capitalization Rates or “Cap Rates” in commercial real estate determine the way income from a property is “capitalized” to determine value. Cap rates are set in the marketplace and generally have a strong relationship to interest rates and returns of other competing

investments such as stocks and bonds. Cap rates can also vary by geographical areas, quality of construction and the local market. Today, cap rates for all kinds of commercial real estate are at historic lows. It is clear from our example that self storage owners are highly likely to have experienced higher values over the last three years than at any other time in their ownership!

Will the High Vales Last?

While it is comforting to know how well you have prospered in recent times from this extraordinary market, several questions hang over the future. Wondering if high values will last is really just a manifestation of wishful thinking, and can probably answered best by the statement: They never have! The more typical historic range for cap rates has been in the 8.0 to 11.0 range. There is not the slightest evidence that the volatility in cap rates and the resulting values have been permanently terminated.

Business is Better; are Values?

This is an interesting but more complex question and is worth exploring in more detail. The answer to the question is not always. If cap rates go up, values may drop. A quick study of the chart below will show that a reversal in the trend of cap rates can cause values to go down despite increased income – and can destroy your equity!

Table II

| | Jan. 2003 | Jan. 2006 | Jan. 2009 |
|----------|-------------|-------------|----------------|
| NOI | \$200,000 | \$200,000 | Your Guess? |
| Cap Rate | 9.45% | 7.5% | |
| Value | \$2,116,000 | \$2,660,000 | |
| Equity* | \$529,000 | \$1,073,000 | |

*Assumes loan of \$1,587,000

As can be seen, rising cap rates can be devastating to the value and, more importantly, your equity investment, even if the income is growing nicely. The question to be answered is this: is the risk of values declining greater than the risk of future gain – and how long do you wait?

What To Do?

First, decide what you want to do and what your particular circumstances are. If you want to keep your facility for, say at least five years or more, and believe that your competitive situation is such that you can maintain and grow your income over that time, then make sure that you have captured a low interest rate on a loan for at least that term. However, if your ownership horizon is less than five years or you are concerned about your long term ability to compete in your market, then selling could be an attractive option. Values are at all time highs and capital gain rates are at all time lows and the chances of cap rates going up (values going down) appear to be significantly greater than having cap rates decline. If you are wondering when to make the decision, my

suggestion is to do so only as soon as you are comfortable. While no one has the ability to predict where rates and values will be a year from now, we can be sure that the “best of times” won’t last forever.

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