ARGUS
Self Storage Sales Network

Market Monitor

America's Premier Self Storage Brokers **Issue IV-2014**

Cap Rates:

Understanding the Nuances of Today's Valuations

by Ben Vestal

In the business of buying and selling self-storage properties around the country, the discussion with both buyers and sellers always ends with cap rates. Unfortunately, most people don't fully understand all of the ramifications of this simple-sounding number. It is also clear that we have many new investors in the marketplace who have never bought an income producing property and are just learning the basic math. Hopefully, this summary will help clarify this mysterious, yet fundamental, concept.

What are Cap Rates and Why Use Them?

Real estate valuation is a very complex business with many variables that affect the price. Over the years, real estate professionals found that they needed a way to compare property values (essentially price) in a market using a shorthand method, thus capitalization rates or "cap rates" came into general use. Essentially, cap rates tell an investor what they should expect to earn as a percentage if they purchased a property using all cash. For example, if an investor thinks a property is worth a 7% cap rate, then they expect to receive an unleveraged 7% cash on cash return.

When the net operating income (NOI) is divided by the cap rate, *voila*, you arrive at a property value. This method is essentially a way to develop a price based on an income stream. The net result is that the lower the cap rate, the higher the value with the flip side being the higher the cap rate, the lower the value. This is only one of three methods used by appraisers to value a property, but it is the one most focused on by investors. It is primarily used because it does a very good job correlating property values and it helps facilitate comparison between markets.

The Underlying Assumptions in Calculating NOI:

As with any good rule of thumb, there are certain assumptions that are implicit in the calculation of the NOI. For cap rates to be useful and comparable, the NOI must be calculated on a consistent basis on all properties. For example, the operating expenses must be similar in nature and somewhat standardized in order to be comparing "apples to apples." The first assumption when calculating the NOI is that all revenues must result from reoccurring operations of the property (rental revenue) and not from an asset sale or insurance recovery. Secondly, depreciation and debt service should not be deducted from revenues to arrive at the NOI. Depreciation and financing costs do not reflect value, but merely reflect tax issues and capital structure. These revenue assumptions are clearly defined and are almost universally applied.

However, assumptions related to expenses are less uniformly applied and often result in significant misunderstanding, particularly among sellers. The assumptions should include that the property is properly insured and advertised in a professional way, and property taxes should be adjusted to what the new valuations will be at the time of sale. Furthermore, the expense numbers need to reflect the market labor cost of running a self-storage property which should include an on-site manager's salary if the owner is currently doing the work for free. It is also assumed that the operating expenses include an off-site management fee over and above the on-site management expense, and this will range between 4% to 6% of the gross revenue depending on the size of the property.

Many owners will say that some of the assumptions don't apply to them for various reasons, but I can assure you that there are almost no exceptions in the marketplace of real sales. In the end, ignoring these assumptions is at best merely self-deception, and at worst, can have serious impacts on the financing or sale of a property.

Why Do Some Properties Have Higher or Lower Cap Rates?

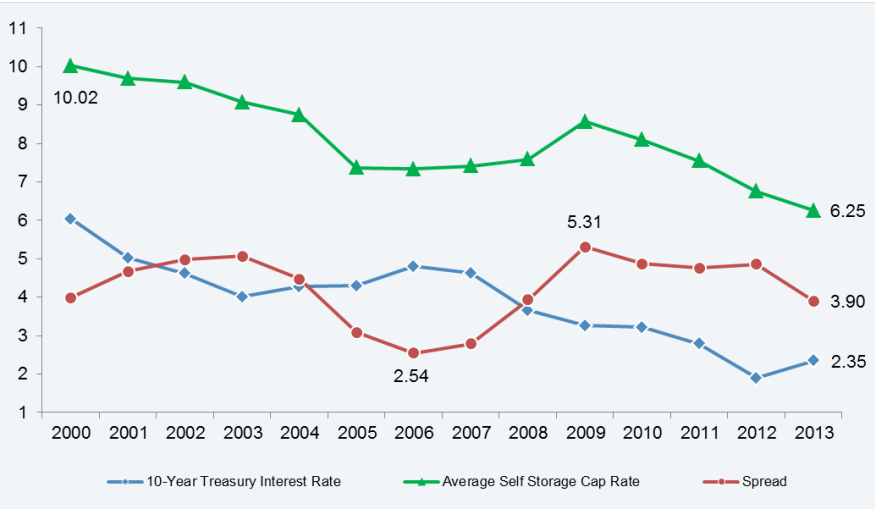
(Continued)

Since all properties are not alike, they can command different cap rates. These variations from "normal" cap rates (today between 6.5%-8%) usually reflect the quality of the project and the risk to the investor. For example, a 40% vacant metal building project in a rural area would require a higher cap rate to reflect the increased risk and lesser quality asset. On the other hand, a large masonry project with full security, in a growing metropolitan area, with consistently increasing rents would command a premium cap rate, perhaps in the range of 6% to 7%. Once again, while the cap rate may vary, the underlying assumptions about the NOI do not. Property valuations are somewhat subjective, but our collective experience would indicate that knowledgeable buyers and sellers agree on the quality of the NOI and on the risk variances that lie in the very narrow range of cap rates.

Do Cap Rates Really Reflect the Market?

The answer is unequivocally, YES!!! If cap rates did not reflect the marketplace accurately, we would not be using them in so many ways. Chart I below will give you an idea of how cap rates have varied over the last 10 years. Please keep in mind that this chart takes into consideration ALL self-storage properties around the country, so remember that a property in a small city or town will not command the same low cap rate as one in San Francisco or midtown Manhattan. As you can see, the market has seen a constant decline in cap rates for self-storage properties over the last ten years, from an average of 10% in 2000 to 6.25% in 2013. This is largely due to the increased industry data that is now available, indicating that the overall risk associated with owning self-storage properties is much less than once thought. Not to mention we have had a great run of low interest rates for the past decade which has also fueled the increase in value of almost all income-producing real estate, including self-storage. However, the most intriguing metric in the chart below is the spread between cap rates and interest rates, indicated by the red line. As you will notice, the trend is less constant than the more consistent Cap Rate and Interest Rate trends. The narrowing of the spreads between cap rates and interest rates today would indicate that the market is realizing once again that the stability of self-storage income streams is very durable.

Chart I: Cap Rates and Interest Rates 2000-2013



Source: Cushman & Wakefield Self Storage Industry Group

The above review of cap rates will provide you with the very basics of how cap rates work and their effect on valuation and should allow you to arrive at a ball park value for your new investment or your current self-storage property. However, you must be impartial when making the judgment call regarding income and expenses and compare your project to other comparable sales in your market to arrive at an appropriate cap rate. If you are considering getting professional advice when evaluating a self-storage investment it is important to consult with a real estate professional that specializes in self-storage. Like any business, there are some things that are unique to self-storage that an average real estate professional may be unfamiliar with regardless of their other experience or intentions. Understanding and setting the value of a property is the single most important step in the investment process. MM

Ben Vestal, President of the Argus Self Storage Sales Network, can be reached at 800-55-STORE or bvestal@argus-realestate.com.

Property Showcase

Tucson, AZ • $1,100,000

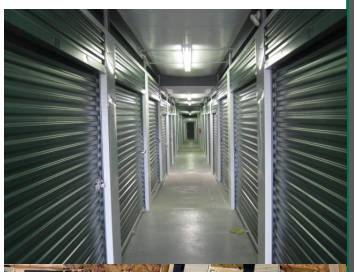
NEW!

- 83 Units
- 20,840 RSF
- 1 Acre
- Includes 12 Office/Warehouse units
- Onsite manager's office and apartment
- Infill location
- Upside potential in rents
- Turnkey property with existing management

Jeff Gorden, CCIM
480-331-8880
jgorden@selfstorage.com

Lee's Summit, MO • $2,650,000

- 344 Units
- 38,137 RSF
- 3.83 Acres
- High visibility location in one of Missouri's fastest growing suburbs in the KC metro
- Extremely strong ancillary income
- Offers climate, open and conventional storage
- 24 hour access



Larry Goldman, CCIM
913-339-0641
lgoldman@selfstorage.com

East Point, GA • $1,475,000

NEW!

- 231 Units
- 24,000 RSF
- 1.06 Acres
- 4 miles north of Atlanta International Airport
- Convenient in-town location
- Computerized gate and access
- Fully fenced
- Some outside parking spaces
- Elevator, security cameras

Mike Patterson, CCIM
770-241-9070
ebroker@msn.com

Canton, OH • $2,500,000

NEW!

- 476 Units
- 74,960 RSF
- 4.44 Acres
- Historically high occupancy
- Interior temperature control units
- Individual unit door alarms
- 30+ security cameras with live feed
- Convenient location near highway interchange

Alec Pacella, CCIM
& Michael Venesky
216-455-0886
apacella@naidaus.com
mvenesky@naidaus.com

Bossier City, LA • $1,098,000

- 345 Units
- 40,170 RSF
- 2.96 Acres
- Stabilized cash flow
- Great visibility
- Ability to decrease expenses and increase income
- Located on a well-traveled road in Bossier City, not far from Barksdale Air Force Base

Tyler Trahant
& Stuart LaGroue
817-840-0055/251-432-1287
ttrahant@selfstorage.com
stuart@selfstorage.com

Chesapeake, VA • $900,000

NEW!

- Self-Storage Development Site
- 73,000 RSF proposed
- 6.5 Acres
- Plans are included
- Located on well-traveled US Route 17
- B2 Zoning
- Site enjoys many nearby rooftops, high traffic counts and little competition
- Bank owned

Stuart Wade
757-618-3597
swade@thenicholsoncompanies.com

Sells Self Storage Nationwide!

- Over $115 million in self storage properties currently for sale, with prices ranging from $290,000 to over $7,200,000 million to meet the needs of every buyer.
- For property details, broker information and helpful industry articles, visit www.argus-selfstorage.com or contact your local Argus Broker Affiliate listed on the back of the Market Monitor!

Alabama			
Foley	$999,500	Bill Barnhill/Shannon Barnes	251-432-1287
		Stuart LaGroue	251-432-1287
Pinson	$1,270,000	Bill Barnhill/Shannon Barnes	251-432-1287
		Stuart LaGroue	251-432-1287
Theodore	$300,000	Bill Barnhill/Stuart LaGroue	251-432-1287
Arizona			
Bullhead City	$403,750	Jeffery A. Gorden	480-331-8880
Bullhead City	$357,000	Jeffery A. Gorden	480-331-8880
Fort Mohave	$500,000	Jeffery A. Gorden	480-331-8880
Tucson	$1,100,000	Jeffery A. Gorden	480-331-8880
Tucson	$1,300,000	Jeffery A. Gorden	480-331-8880
Arkansas			
Hiwasse	$599,000	Larry Goldman	913-339-0641
California			
Vallejo	In Contract	Tom de Jong	408-282-3829
Vallejo	$1,850,000	Tom de Jong	408-282-3829
Woodland	$6.50 PSF	Tom de Jong	408-282-3829
Yreka	$493,700	Tom de Jong	408-282-3829
Colorado			
Colo Springs	$7,200,000	Joan Lucas	720-855-6587
Grand Junction	$1,650,000	Joan Lucas	720-855-6587
Loveland	$2,400,000	Joan Lucas	720-855-6587
Florida			
Jacksonville	**SOLD!**	W. Frost Weaver	904-265-2001
Lake City	$325,000	John W. Hill	386-362-3300
New Port Richey	$425,000	Chuck Grey/Jeff Grey	727-849-2424
St. Augustine	$2,200,000	W. Frost Weaver	904-265-2001
Georgia			
Carrollton	**SOLD!**	Mike Patterson	770-241-9070
Douglasville	$1,625,000	Mike Patterson	770-241-9070
East Point	$1,475,000	Mike Patterson	770-241-9070
Villa Rica	$1,200,000	Mike Patterson	770-241-9070
Villa Rica	$880,000	Mike Patterson	770-241-9070
Winston	$292,000	Mike Patterson	770-241-9070
Illinois			
Danville	$990,000	Larry Goldman	913-339-0641
Dupo	$895,000	Larry Goldman	913-339-0641
Kansas			
Iola	$530,000	Larry Goldman	913-339-0641
Junction City	$1,895,000	Larry Goldman	913-339-0641
Topeka	$1,795,000	Larry Goldman	913-339-0641
Louisiana			
Bossier City	$1,098,000	Tyler Trahant/	817-840-0055
		Stuart LaGroue/Shannon Barnes	251-432-1287
Michigan			
Lapeer	$785,000	Jim Soltis	810-494-2062
Sturgis	$369,000	Jim Soltis	810-494-2062
Missouri			
Arnold	$1,330,000	Larry Goldman	913-339-0641
Branson West	$895,000	Larry Goldman	913-339-0641
Lee's Summit	$2,650,000	Larry Goldman	913-339-0641
Mount Vernon	$1,100,000	Larry Goldman	913-339-0641
Sunrise Beach	$1,870,000	Larry Goldman	913-339-0641
Mississippi			
Canton	$850,000	Bill Barnhill/Stuart LaGroue	251-432-1287
Leland	$220,000	Bill Barnhill/Stuart LaGroue	251-432-1287
3-Prop. Portfolio	$4,500,000	Bill Barnhill/Stuart LaGroue	251-432-1287
New Hampshire			
Claremont	$290,000	Joe Mendola	603-668-7000
Fitzwilliam	$625,000	Joe Mendola	603-668-7000
New Jersey			
Branchville	$1,950,000	Linda Cinelli	908-722-5661
Hackettstown	$4,400,000	Linda Cinelli	908-722-5661
Montague	$1,600,000	Linda Cinelli	908-722-5661
Pemberton	$975,000	Linda Cinelli	908-722-5661
New Mexico			
Mesilla Park	$625,000	David Etzold/Noel Woodwell	915-491-9610
New York			
Hicksville	$4,200,000	Linda Cinelli	908-722-5661
Islip	$3,995,000	Linda Cinelli	908-722-5661
Middletown	$450,000	Linda Cinelli	908-722-5661
Modena	$995,000	Linda Cinelli	908-722-5661
Monticello	$4,500,000	Linda Cinelli	908-722-5661
Peekskill	$3,500,000	Linda Cinelli	908-722-5661
Port Jervis	$1,600,000	Linda Cinelli	908-722-5661
North Dakota			
Watford City	$1,200,000	Bruce Bahrmasel	312-518-3550
Ohio			
Canton	$2,500,000	Alec Pacella/Michael Venesky	216-455-0886
Canton	$1,150,000	Alec Pacella/Michael Venesky	216-455-0886
Cleveland	$2,300,000	Alec Pacella/Michael Venesky	216-455-0886
Elyria	$2,699,000	Alec Pacella/Michael Venesky	216-455-0886
Painesville	Call Broker	Alec Pacella/Michael Venesky	216-455-0886
Sheffield Vill.	$1,050,000	Alec Pacella/Michael Venesky	216-455-0886
Washington CH	$355,000	Alec Pacella/Michael Venesky	216-455-0886
Zanesville	$585,000	Alec Pacella/Michael Venesky	216-455-0886
Oklahoma			
Moore	$1,450,000	Jared Jones	918-583-3483
Oregon			
Klamath Falls	$697,000	Steve Boldish	541-776-1031
Klamath Falls	$1,494,000	Steve Boldish	541-776-1031
Pennsylvania			
Bechtelsville	$1,350,000	Chuck Shields	610-828-0100
Matamoras	$1,100,000	Linda Cinelli	908-722-5661
Olyphant	$850,000	Chuck Shields	610-828-0100
Texas			
Fort Worth	$4,600,000	Tyler Trahant/Richard Minker	817-840-0055
Virginia			
Chesapeake	$900,000	Stuart Wade	757-618-3597
Portsmouth	$2,100,000	Stuart Wade	757-618-3597
Williamsburg	$6,650,000	Stuart Wade	757-618-3597
Wisconsin			
Milwaukee	$2,262,000	Matson Holbrook	414-270-4108

ARGUS SALES

Congratulations to Mike Patterson, CCIM, of Commercial Realty Services of West Georgia who sold Able Self Storage in Carrollton, GA! Contact Mike at 770-241-9070 for more information.

Congratulations to Frost Weaver, of Weaver Realty Group who sold Jax Storage Mall I in Jacksonville, FL! Contact Frost at 904-265-2001 for more information.

Argus Broker Affiliate Wins Top Producer Award

Argus Self Storage Sales Network is proud to award Broker Affiliate Bill Brownfield, CRE, CCIM of MKP Self Storage LLC the **Top Producer Award** for completing the most self-storage transactions in 2013. The award was presented at the annual Argus Broker meeting held at the ISS Expo in Las Vegas. Bill is based in Houston, TX and represents Argus in the South and Central Texas markets. He can be reached at 713-907-6497 or bill@wbrownfield.com.

Contact an Argus Broker Affiliate

NORTHEAST	Company	Phone	Territory
Guy Blake, CCIM	Pyramid Brokerage Company	845-522-5900	Upstate NY, Western CT
Linda Cinelli, CCIM, CEA	LC Realty	908-722-5661	Northern NJ, NY (NYC, Long Island)
Joseph Mendola	NAI Norwood Group	603-668-7000	MA, ME, NH VT, Eastern CT
Chuck Shields	Beacon Commercial Real Estate	610-862-1645	Eastern PA, Southern NJ, DE
SOUTHEAST			
Bill Barnhill, CCIM	Omega Properties, Inc.	888-801-4534	FL Panhandle
N.J. "Joey" Godbold	Percival McGuire Commercial Real Estate	704-632-1027	NC, SC
Mike Patterson, CCIM	Commercial Realty Services of West Georgia	770-241-9070	GA
Stuart Wade	The Nicholson Companies	757-618-3597	MD, VA
Frost Weaver (FL Commercial Brokers Network)	Weaver Realty Group, Inc.	904-733-0039	North, Central & South FL
NORTH CENTRAL			
Bruce Bahrmasel	Landstar Realty Group	312-518-3550	Northern IL, Northern IN
Alec Pacella, CCIM & Michael Venesky	NAI Daus	216-831-3310	OH, Western PA
Larry Goldman, CCIM	RE/MAX Best Associates	913-339-0641	KS, MO, Southern IL
Mike Helline & Paul Grisanti, CCIM	Grisanti Group Commercial Real Estate	502-253-1811	KY, Southern IN
Matson Holbrook, CCIM & Max Schultz	Siegel-Gallagher, Inc.	414-270-4108	WI
Jim Soltis	Preview Properties.com	810-494-2062	MI
SOUTH CENTRAL			
Bill Barnhill, CCIM	Omega Properties, Inc.	888-801-4534	AL, MS, LA
Bill Brownfield, CRE, CCIM	MKP Self Storage LLC	713-907-6497	South & Central TX
David Etzold & Noel Woodwell	Etzold & Co.	915-845-6006	West TX
Larry Goldman, CCIM	RE/MAX Best Associates	913-339-0641	AR
Mike Helline & Paul Grisanti, CCIM	Grisanti Group Commercial Real Estate	502-253-1811	TN
Jared Jones, CCIM	Porthaven Partners	918-583-3483	OK
Richard D. Minker, CCIM & Tyler Trahant	CASE Commercial Real Estate Partners	817-335-5600	North TX
WEST			
Steve Boldish, CCIM	Oregon Self Storage Brokers	541-776-1031	OR
Tyler Clay, Bob Southern & Nicholas Maerz	Coldwell Banker Commercial Clay & Associates	775-829-5900	NV
Tom de Jong	Colliers International	408-282-3829	Northern CA
David Etzold & Noel Woodwell	Etzold & Co.	915-845-6006	NM
Jeffery A. Gorden, CCIM	Eagle Commercial Realty Services	480-331-8880	AZ
Larry Hayes	Hayes & Associates	406-728-0088	ID, MT
Joan Lucas	Joan Lucas Real Estate Services, LLC	720-855-6587	CO
Jason Wilcox, CCIM	RAVEN Commercial Real Estate	206-919-7643	WA