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Self-storage is back in the spotlight

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Self-storage is experiencing its day in the sun after years of being perceived as a niche investment sub-type, neither neatly classified as industrial, apartment, or retail, as it maintains characteristics of each. Self-storage often physically resembles industrial space, its onsite point of sale business and prevailing development preference for street visibility and exposure are similar to retail use, while its short-term lease and diversified tenant roster, resembles apartment or hotel operations. According to an analysis of NARIET data, during the period 2008 through 2012, the self-storage group not only achieved the highest average total annual return (18.85%) in comparison to office, industrial, retail, and apartment groups, but did so with the lowest standard deviation. Aided and enforced by its recently proven "recession-resistant" character, self-storage continues to command increasing attention and acceptance from institutional-grade investors.

Usage

As self-storage has matured, supply has broadened to offer amenities catering to a variety of preferences and price points. Many newer self-storage developments occur along prime retail corridors and offer appearance and amenities similar to office buildings, such as the inclusion of conference rooms for tenant use. Multiple TV series have increased the exposure of this product among the general public (and fed the appetite for potential auction treasures).

Self-storage usage is seasonal, with occupancies generally reaching the peak in early summer (May/June) and nadir around December. Usage is divided between residential and business tenants. Average occupancy is typically longer among business than residential users. Residential tenants more often use storage for unplanned or intermediate life change events, such as marriage, divorce, care or death of a family member, military deployment, foreclosure or employment move. The frequency and variety of these inevitable events are not tied to the prevailing economic cycle, such as with industrial or office use, which provides a diverse and stable source of demand for storage.

Operational

An often cited strength of self-storage is the relatively low operating costs and low reoccurring capital costs relative to other property types (no tenant work letters or leasing commissions). The success of a self-storage operation can not overlook the adequacy of on and off-site management, which as a percent of effective gross income (EGI) is greater than for other property-types such as retail or industrial. Self-storage success weighs heavily on the daily sales skills and flexibility of the on-site leasing staff as well as the strategic and marketing strategy of the owner or asset manager. Self-storage off-site management typically ranges from 4 to 6% of EGI. Self-storage operations among the more sophisticated facilities continue to advance with management software that can adjust to near-term changes in demand. Operators are also increasing ways to drive net income beyond traditional storage and moving supply (shipping boxes) revenue. Operators are increasingly offering tenant insurance, temperature- and humidity controlled wine and art storage, covered RV parking, and indoor classic car and luxury vehicle storage.

Development

Self-storage is a highly localized, neighborhood-specific demand business. Market conditions dictating demand can vary widely within different parts of the same city or region. For instance, trade areas generally range from a one-mile radius or less in dense urban areas of New York City and its surrounding communities, to two to four-mile radii in suburban locations such as southwestern and central Connecticut, to four-miles plus in rural locations.

Other factors such as the preference among a particular trade area base for particular unit sizes, unit types, or facility amenities can vary greatly and have a direct impact on the success of a facility. Denser locations tend to have a greater demand and acceptance of smaller unit sizes and interior located units, while suburban locations will likely have greater need for larger unit sizes and drive-up style units. As such, a neighborhood level research analysis is critical in analyzing demand for a specific location given surrounding trade area preferences.

Given the very localized nature of user supply and demand, one competitor entrant to a existing operator's trade area can impact occupancy materially. The low level of new construction across the country following the recession has been a major point of strength viewed by investors, however, new construction activity appears to be increasing following the stabilization of the economy and loosening of the debt market.

Investment

Capital has been flowing to self-storage acquisitions in the past two years at accelerated and significant levels, consistently driving down capitalization rates. Brokers often report more buyers than sellers in the current market. However, investment demand has been tiered. Sales activity has been predominately concentrated among institutional-grade buyers, often occurring through multiple property portfolio acquisitions, and targeted at good quality facilities located in dense, metro areas. Since the start of the recession, Connecticut along with the rest of the Northeast, has experienced relatively sparse self-storage sales activity, contrasted by the significant volume occurring in the New York - New Jersey metro area. Primary markets are commanding the majority of investment capital, with secondary and tertiary markets achieving less attention. The most prevalent buyers are the public- and non-public REITS, who have access to the lowest capital cost, and national private equity firms.

Primary markets, such as the direct New York City area are achieving capitalization rates ranging from 5.5% to 7%, while secondary and tertiary markets, when activity does occur, are in the range of 7% to 9%. Exceptions will vary depending on specific location and facility characteristics.

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