Mick Law, P.C. 2019 Storage Industry Market Report

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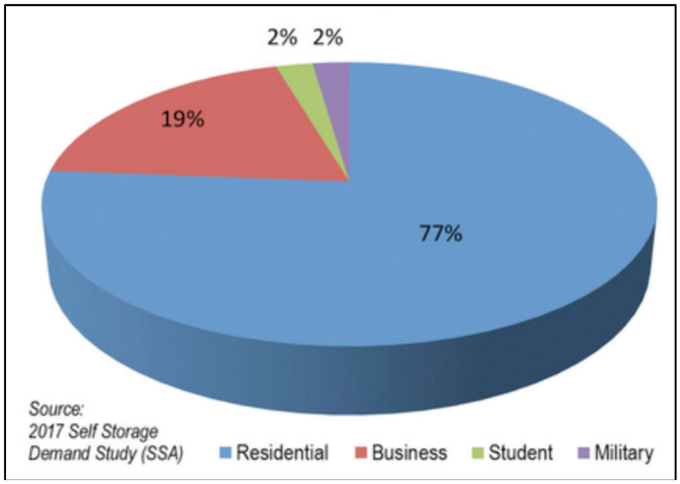
The attorneys and underwriters at Mick Law, P.C. LLO, have reviewed more storage asset DST and development projects over the past 12 months versus our historical experience in the asset class. Anticipating that we and you may see more opportunities in this space as pricing in some of the traditional real estate asset classes remains aggressive, we provide you below our 2019 storage market report.

Industry Overview

According to the 2019 Self-Storage Almanac, there are approximately 45,547 self-storage facilities in the nation totaling over 22.0 million units. In total, there are nearly 1.7 billion square feet of self-storage space, or approximately 5.4 rentable square feet of self-storage for every man, woman and child living in the U.S. The average self-storage property measures 37,523 square feet. In comparison to historical standards, today's self-storage facilities are larger, however are equipped with a fewer number of storage units. This would indicate that developers are building a number of larger storage units within their projects and existing projects may be converting units to meet the demands of their customers.

Self-storage customers typically fall into one of four categories, namely, residential, business or commercial, military, and students. Residential is by far the greatest category of renter, with approximately 77% of all self-storage units occupied by residential renters. Although 68% of all residential renters live in a single-family home, a number of life changes including a relocation, change in family status, the birth or death of a family member, or a household remodeling project can attract them towards self-storage rental. In addition, many apartment or condominium renters do not have enough storage space where they live and are seeking a longer-term storage solution. Commercial tenants make up an increasingly larger portion of self-storage. At 19% of total units, most commercial tenants are small business owners or contractors who need to store equipment or inventory off-site. Military and defense spending and relocations continue to be a large driver of self-storage demand with 2.0% of total units leased to military personnel. Many military renters are enlisted servicemen and women who need a storage facility to house their belongings while away in training or on deployment. Finally, approximately 2.0% of the nation's self-storage renters are students. Below is a breakdown of self-storage customers:

Average Tenant Mix



Texas continues its long-term reign as the state with the most self-storage facilities in the country. In 2018, this state alone was home to 4,904 self-storage projects totaling 207,150,002 square feet, or approximately 12.1% of the nation's self-storage. By contrast the District of Columbia has the fewest storage properties in operation with just 19 facilities in operation with 1,211,000 square feet of space. The District of Columbia also has the fewest number of square feet per person at 1.84, followed closely by New York, Hawaii and Maine, all with less than 3.0 square feet per person. On a per capita basis, residents of Idaho currently have access to the most square feet of storage in the nation; the state boasts 10.76 rentable square feet of self-storage per person.

Looking at the data on a smaller scale by Metropolitan Statistical Area ("MSA"), the Dallas-Fort Worth -Arlington MSA has the greatest number of facilities, with 1,198 operating self-storage facilities within the MSA boundaries for a total of 58.9 million square feet of space or approximately 8.47 square feet per person. In terms of per capita rentable square footage, the Daphne-Fairhope-Foley, Alabama MSA tops the list with 12.84 square feet of storage space per person.

Top Operators

Although the self-storage industry is dominated by small, private operators, the top six operators within the self-storage industry are all public companies, the largest of which is Public Storage. Public Storage (NYSE:PSA) was founded in 1972 and today remains the dominant force in the industry. With 2,630 facilities under ownership totaling 173,000,000 square feet, the company owns and operates approximately 5.8% of all storage facilities in the nation. Distinct from its competitors, the company does not offer third-party management services of non-owned facilities. Public Storage has continued efforts to acquire additional units. During the third quarter of 2018, the company acquired 11 facilities; six in Minnesota, two in Texas and one in Ohio, South Carolina and Tennessee.

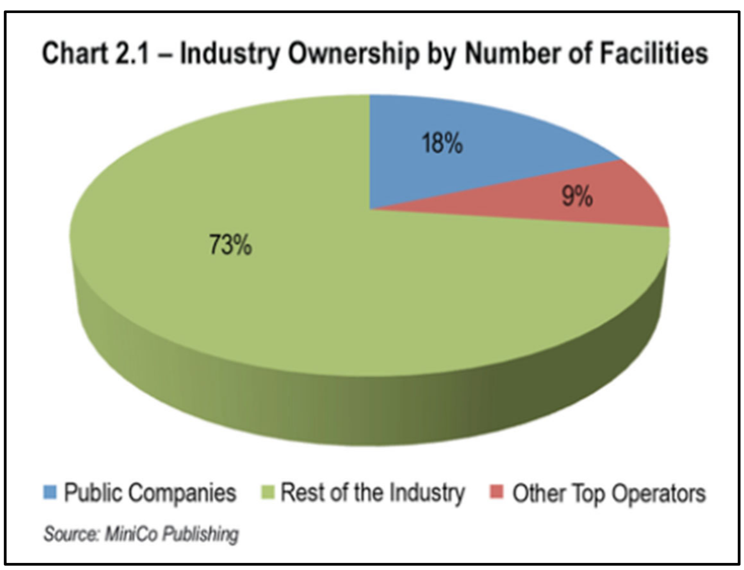
A summary of the 10 largest self-storage operators is outlined below:

Ranking	Company Name	Number of Facilities	Square Feet	Number of Units	Market Share
1	Public Storage	2630	173,000,000	1,535,000	10.13%
2	Extra Space Storage	1568	119,275,324	763,561	6.98%
3	CubeSmart	1048	70,900,000	405,000	4.15%
4	U-Haul International	1580	58,038,818	375,164	3.40%
5	National Storage Affiliates	819	52,300,000	340,000	3.06%
6	Life Storage	723	50,810,000	424,527	2.97%
7	StorageMart	204	13,221,027	71,134	0.77%
8	StorQuest	151	10,500,761	69,542	0.61%
9	SmartStop Asset Management	135	9,976,000	74,160	0.58%
10	Metro Storage	142	9,600,000	81,000	0.56%

Beyond the sector's largest operators, the segment is highly fragmented and competitive. The combined market share (by square footage) of the 10 largest operators is 32%.

The industry has hundreds of mid-sized companies operating chains of from three to 100 stores, the vast majority of which are owner-operators. There are still more than 26,000 single facility owner-operators.

There are six public corporations operating in the industry: Public Storage, Extra Space Storage, Cube-Smart, National Storage Affiliates Trust, Life Storage, Inc. and U-Haul International. Five of the public companies are organized as REITs while Phoenix, Arizona based U-Haul International is publicly traded, however, is not organized as a REIT. Together these public companies own 18% of the self-storage facilities in the nation. A chart outlining the ownership of these public companies is as follows;



Self-storage operations in the top 25 to 50 markets are controlled primarily by large, sophisticated companies, giving them a greater percentage of ownership in these markets compared to self-storage across all markets in the U.S. This can be attributable to very different dynamics. First, the larger operators prefer these metro areas because they are able to get the highest rents in the market, often coupled with higher occupancy rates. Second, because the larger operators are typically better capitalized, they can afford to pay higher land costs to develop and higher acquisition prices to purchase facilities in these markets.

Current Trends

Strategies for best operating a self-storage business have evolved over the years as the industry has grown and matured. In the earliest days of the self-storage sector, most facilities were small, independent businesses run by sole proprietors. Today, mom and pop operations remain common, but the industry has shifted more towards career management professionals. As recently as five years ago, more than one-third of managers fell into the owner-manager category. This number has declined almost every successive year, and currently, slightly more than 10% of storage facilities are managed by the owner.

The average self-storage facility has changed over time. While first generation storage properties showcased row after row of single story metal buildings equipped with bright orange roll-up doors, the self-storage stores being constructed today often mirror the styles used in neighboring structures, with upscale architectural features and highly detailed exterior design plans that blend in with the surroundings.

Strong customer service and ancillary services are becoming a top priority for self-storage consumers. Over 75% of self-storage operators now report the sale of ancillary items at their facilities including boxes, moving supplies and moving vehicle rentals. In addition, over 65% of operators sell insurance at their facilities, a 12% increase over the past 12 months. Car washes are becoming a common attraction at self-storage facilities. Although more common with high-service facilities including RV, camper or boat storage facilities, 6.0% of facilities now report an on-site car wash.

National Market Fundamentals

According to REIS.com, as of the third quarter of 2018 (the most recent report as of the date of this report) the national vacancy rate was 11.8%, up 60 basis points over the mid-year 2018 vacancy rate, up 140 basis points over the level found one year ago and up 260 basis points from the cycle-low vacancy rate of 9.2%, found during the 2nd quarter of 2016. Marcus and Millichap reported a similar increase of 40 basis points to reach a vacancy rate of 10.0% within its 2018 Second Half Outlook. The Marcus and Millichap report notes that demand for storage space continues to strengthen with a healthy job market and rising wages. Though demand is near peak, new construction has pushed beyond demand forcing the vacancy to increase, although the vacancy rate has hovered in the same range for the past year. Areas of oversaturation already exist, characterized by greater concessions, lower occupancy and negative rent growth. Nonetheless, on the whole, the market remains intact. Despite predictions of doom and gloom the reality is a more balanced market than analysts had forecast.

Self-storage has historically seen much greater swings in fundamentals year-over-year than the other major commercial real estate product types, as is evidenced by the 230-basis point increase in vacancy rate between the 3rd quarter of 2017 and the 3rd quarter of 2018.

The forecast nationally is for vacancy rates to rise, albeit at a slower pace than had previously been forecast. Elevated consumption, related to increasing multifamily lifestyles, where residents don't have room to accommodate all of their belongings will result in stable demand, however, new development will out-pace demand in 2019. The forecast from REIS called for a vacancy rate of 12.8% by year-end 2018 with a stabilization thereafter with the vacancy rate remaining under 13.0% throughout the five-year forecast horizon.

Asking rental rate growth across the nation was positive in 2018, with rental rate escalation forecast (when year-end numbers are completed) at 1.3% for non-climate controlled and .5% for climate controlled. The average monthly rental rates for the five most common unit sizes are outlined below:

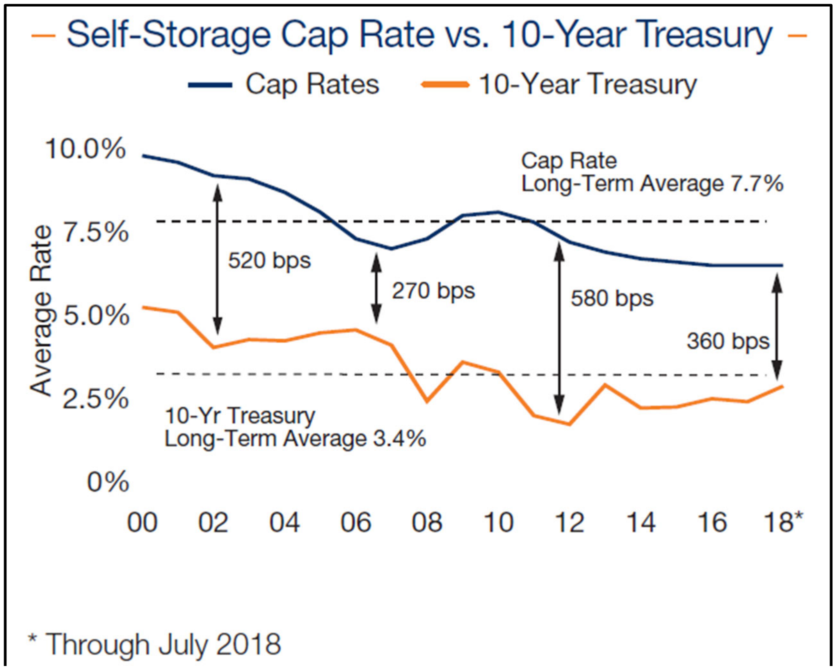
Unit Type	5X5	5X10	10X10	10X15	10X20
Non Climate Controlled	$ 58.01	$ 79.80	$ 123.12	$ 159.00	$ 189.71
Climate Controlled	$ 70.71	$ 100.26	$ 156.02	$ 203.14	$ 252.03

Investment Market

According to the Marcus and Millichap Second Half 2018 Self-Storage Report, the self-storage investment market continues to remain strong as properties are in high demand. Both institutional and private buyers are pursuing self-storage opportunities with higher yields amid weak returns from core real estate holdings. Competitive bidding has advanced the average price per square foot by 11% over the 12-month period ending June 2018. For recently traded assets, the average initial cap rate is in mid-6% range, down from the low-8% range of 2010.

Overall, higher sales prices are enticing owners to bring their assets to market, however, higher borrowing costs are narrowing the margin for buyers. In order to maintain yield, many REITs are now pursuing Class B, and secondary market opportunities, where they had historically only invested in Class A product located in top tier markets. Lenders will remain active in providing financing for self-storage opportunities, however, many capital providers have become increasingly selective as they re-assess risk.

On a regional basis, the average price per square foot increased in all regions of the nation. The greatest price increase was in the Midwest region of the nation, where pricing increased by 9.6% to an average of $80/SF. The highest pricing in the nation is the Northeast region where pricing averages $175/SF. As of mid-year 2018, the long-term average self-storage cap rate was 7.7%, as compared to a 10-year treasury long-term average yield of 3.4%. A summary of the historical average cap rate over the past several years and a comparison to US Treasury Rates may be found below:



Conclusion

In summary, we acknowledge that with any commercial real estate investment offering the asset must be underwritten on a submarket basis, and such market conditions may vary substantially. Historically, self-storage has experienced greater swings in vacancy, and rental rate fundamentals and are therefore less predictable financial performers than other asset classes. We also acknowledge that the current state of the storage market is healthier than we predicted in June, 2018, based then upon the Q1 2018 data. However, the reversion to the mean on vacancy rates that we discussed then is playing out on a national basis as vacancy rates are now in the double digits and expected to creep up another 120-300 basis points, depending on the forecast source. We continue to believe that cap rates will also increase further, and considering the historical spreads over an 18-year period reflected in the chart above and the anomaly of circa 2007, cap rates in many markets may approach and exceed 8% in 2019.