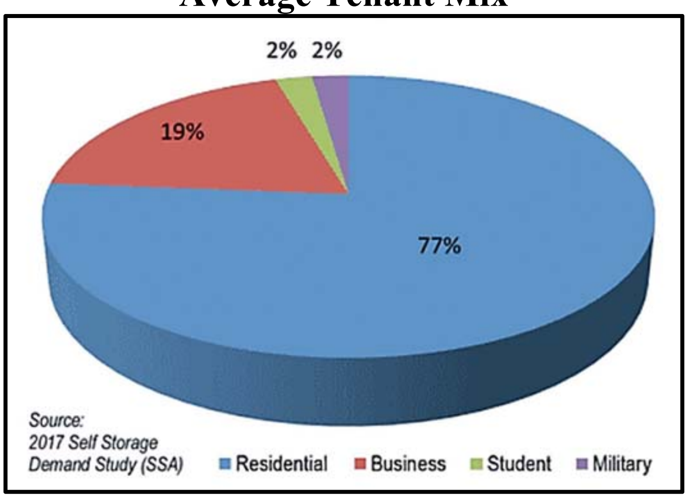
April 26, 2018

Self-Storage Industry Overview

According to the 2018 Self-Storage Almanac, there are approximately 44,149 self-storage facilities in the nation totaling over 21.3 million units. In total, there are nearly 2.3 billion square feet of self-storage space, or approximately 7.06 rentable square feet of self-storage for every man, woman and child living in the U.S. The average self-storage property measures 52,352 square feet and contains 484 units. 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 - 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.

Average Tenant Mix



Texas continues its long-term reign as the state with the most self-storage facilities in the country. In 2017, this state alone was home to 4,475 self-storage projects totaling 234,275,200 square feet, or approximately 10.1% of the nation's self-storage. By contrast the District of Columbia has the fewest storage properties in operation with just 20 facilities in operation with 1,047,000 square feet of space. The District of Columbia also has the fewest number of square feet per person at 1.55, followed closely by Hawaii and New York, both with less than 3.5 square feet per person. On a per capita basis, residents of Montana currently have access to the most square feet of storage in the nation; the state boasts 18.4 rentable square feet of self-storage per person.

Looking at the data on a smaller scale by Metropolitan Statistical Area (MSA), the New York-Newark-Jersey City MSA has the greatest number of facilities, with 1,104 operating self-storage facilities within the MSA boundaries for a total of 57.8 million square feet of space or approximately 2.82 square feet per person. In terms of per capita rentable square footage, the Tulsa, Oklahoma MSA tops the list with 10.73 square feet of storage space per person.

Top Operators

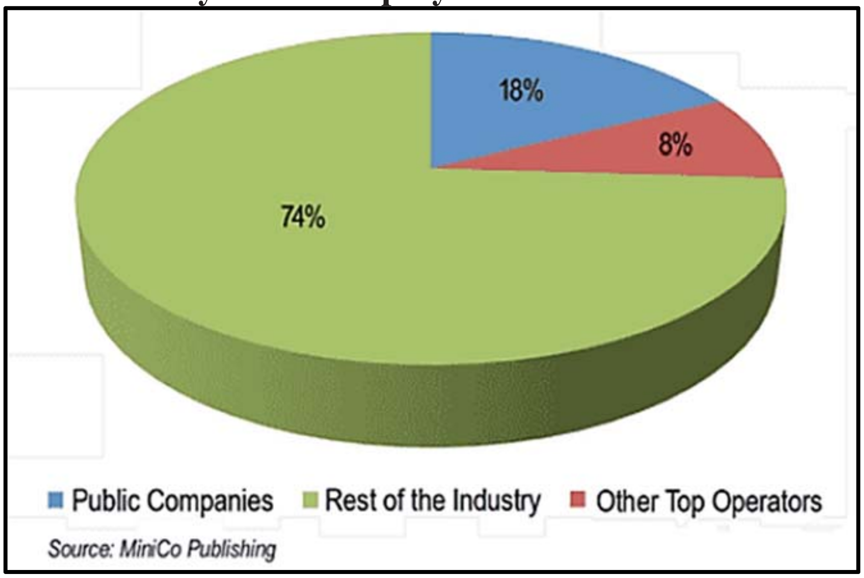
Although the self-storage industry is dominated by small, private operators, the top six operators within the self-storage industry are all public companies, the largest of which is Public Storage (NYSE:PSA). Public Storage was founded in 1972 and today remains the dominant force in the industry. With 2,578 facilities under ownership totaling 168,000,000 square feet, the company owns and operates approximately 7.27 percent 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. Between 2013 and 2016 the company acquired 271 facilities totaling 19.0 million square feet from third parties for approximately $2.5 billion. Subsequent to December 31, 2017 Public Storage was under contract to acquire two properties totaling $18.3 million and had development projects which will add 4.6 million square feet of space at a cost of $613.8 million.

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

Ranking	Company Name	Number of Facilities	Net SF	Number of Units	Market Share
1	Public Storage	2578	168,000,000	N/A	7.27%
2	Extra Space Storage	1470	111,112,483	1,001,221	4.81%
3	CubeSmart	919	62,300,000	601,000	2.70%
4	U-haul International	1482	53,044,380	604,317	2.30%
5	Life Storage (f/k/a Uncle Bob's)	702	49,355,000	444,910	2.14%
6	National Storage Affiliates	629	39,700,000	313,900	1.72%
7	Simply Self Storage	230	18,171,998	137,711	0.79%
8	Storagemart	196	12,966,512	116,239	0.56%
9	The William Warren Group	137	9,600,000	88,000	0.42%
10	MetroStorage	144	9,329,397	80,990	0.40%

Beyond the sector's largest operators, the segment is highly fragmented and competitive. The combined market share (by number of facilities) of the ten largest operators is just 16.7%. The combined market share of the top 100 operators is 26.0%. A chart outlining industry ownership is detailed below:

Industry Ownership by Number of Facilities



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

There are six public corporations operating in the industry: Public Storage, Extra Space Storage, Cube-Smart, Life Storage, Inc. (formerly operated under the trade name Uncle Bob's Self Storage), National Storage Affiliates Trust and U-Haul International, five of which are real estate investment trusts or REIT's while U-Haul is a non-REIT public company.

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 ten percent 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 the REIS.com, as of year-end 2017 the national vacancy rate was 11.5%, up 190 basis points over the mid-year 2017 vacancy rate, and up 230 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 80 basis points to reach a vacancy rate of 11.1% within its 2017 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 for the first time since the recession. 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 2nd quarter of 2016 and the 4th quarter of 2017.

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 their belongings, will result in stable demand, however, new development will out-pace demand later this year. The forecast calls for a vacancy rate of 12.1% by year-end 2018 and 12.3% by year-end 2022.

Asking rental rate growth across the nation was positive in 2017, with rental rate escalation of 1.3% in 2017 for non-climate controlled and .7% for climate controlled. The average monthly rental rates for the five most common unit sizes are outlined below:

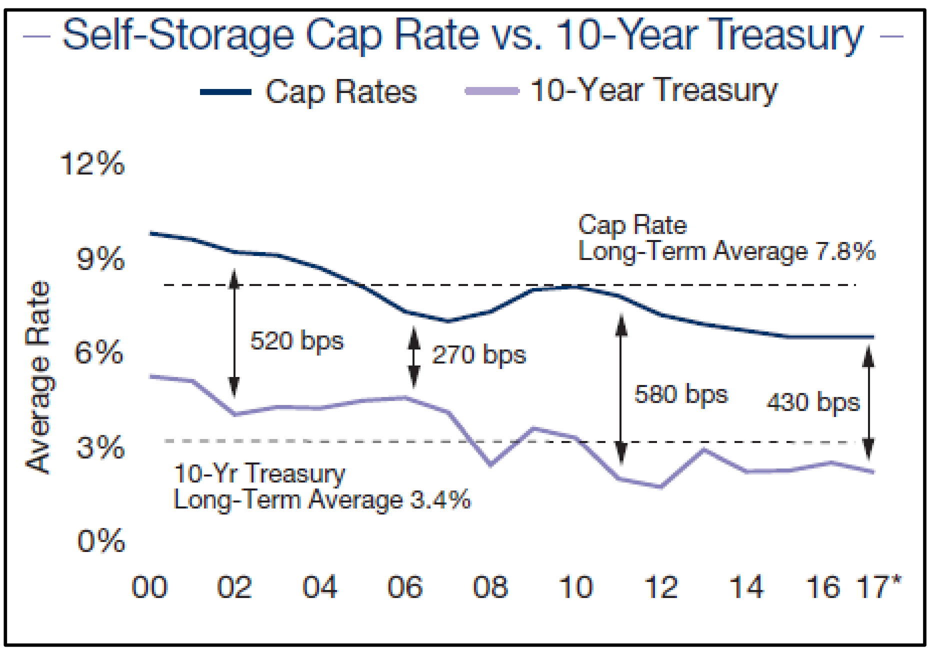
Unit Type	**5x5**	**5x10**	**10x10**	**10x15**	**10x20**
Non Climate Controlled	$56.85	$77.55	$120.11	$155.15	$184.30
Climate Controlled	$69.47	$98.34	$153.09	$198.86	$248.18

Investment Market

According to the Marcus and Millichap 2017 Semi-Annual Self-Storage Report, there is a growing disparity between buyer and seller pricing expectations. Property owners are seeking peak pricing while buyers have tempered their aggressiveness amid slipping revenue growth projections. A noticeable uptick in vacancy rates has REITS and institutional buyers moving to the sidelines, providing private investors an opportunity. Moving forward, stabilized assets with quality underwriting based upon current incomes will receive considerable investor interest while pro-forma deals predicated on substantial future income growth will prove difficult to close.

Robust underlying drivers of demand encourage the continued supply of self-storage financing, though underwriting standards are tightening. Mounting supply pressure coupled with greater risk-retention rules have heightened lender discipline, particularly for construction loans.

On a regional basis, pricing among the five regions of the nation was split. For the six-months ending June 30, 2017 pricing was down within the southwest and northeast, up in the Midwest and south Atlantic and was unchanged within the West. As of mid-year 2017 (the most recent data released as of the date of this opinion), the long-term average self-storage cap rate was 7.8%, as compared to a long-term average 10-year treasury 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

While we acknowledge that real estate development and ownership is an exercise in local submarket analysis by product type, we are seeing negative trends in occupancy, absorption and rental pricing power that lead us to conclude that acquisition at market pricing of "stabilized" assets in the self-storage space may prove to be a difficult investment thesis going forward. Furthermore, if shorter term Fed interest rate increases move along the yield curve (we have witnessed this starting to take place as the ten-year treasury yield has recently crossed the 3% threshold), we do expect valuations of current assets to further erode, potentially resulting in cap rates approaching within 50-100 basis points of the long-term average. Those that buy self-storage facilities in the 6% range today will experience a loss of capital on disposition. If an investor is seeking “value” (a nebulous term in the current pricing environment) in the self-storage space, it should be via development, mezz or preferred equity, ie not the last common dollar of equity in a project.

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