



THE
LeClaire

GROUP

NATIONAL SELF-STORAGE
REPORT 2ND HALF 2018

Self-Storage Research

Second Half 2018

Rising Demand Temporarily Overshadowed by Construction Swell

Positive economic momentum supporting need for self-storage as supply wave slows rent growth. The economy is exhibiting strong growth in 2018, a boon for self-storage real estate. Consistent job gains are allowing more recent college graduates and other young individuals the financial freedom to move out on their own. Amid rising homeownership costs, many are renting apartments, where limited floorspace creates a heightened need for external storage. Older members of the population are also placing more of their possessions in storage units as they downsize. These factors are lifting the long-term demand for self-storage, facilitating a need for additional space. Total self-storage construction over this economic cycle has fallen short of the previous growth period, with a more subdued pipeline immediately following the Great Recession. Over the last few years, however, developers have become increasingly active and they will bring

a record amount of storage space to the market in 2018. The magnitude of completions will create pockets of oversupply risk in multiple metros, adding upward pressure to vacancy. In order to lease units, many operators are strategically discounting marketed rates, inhibiting overall rent growth this year while bolstering longer-term revenue for when supply-side pressures abate, as they are expected to in 2019.

Investor competition driving price growth, prompting expanded acquisition criteria. Interest in self-storage properties remains high as long-term renter demand improves. Competitive bidding has advanced the average price per square foot 11 percent over the 12-month period ending in June to \$108 per square foot. For assets traded in this time period, the average initial yield lay in the mid-6 percent zone, down from the low-8 percent band in 2010.

Overall, higher sales prices are enticing owners interested in exchanging holdings to bring their assets to market during the final months of 2018. Yet, as the year progresses, the prospect of rising lending costs due to interest rate hikes is narrowing the operational margins for buyers. The combination of higher prices and lower first-year returns has created a buyer/seller expectations gap in some scenarios. Many buyers seeking higher cap rates are moving toward secondary and tertiary markets. Here initial returns range in the mid-6 to low-7 percent band. As the number of self-storage properties completed is high nationally, and some developers are not interested in owning and managing facilities, investors are also acquiring recent completions. Often this occurs when the certificate of occupancy is issued or during the initial leasing period. These assets trade with a pro forma cap rate in the 7 to 8 percent range.

2018 Self-Storage Outlook

1.6% increase
in total employment



Employment:

Employers across the United States will create 2.3 million additional jobs in 2018, expanding the national workforce by 1.6 percent. Last year employment grew by 1.5 percent.

77 million square feet
will be completed



Construction:

This year, a record amount of storage space will be delivered as annual completions reach their highest level this cycle. The pace of arrivals is anticipated to slow in 2019 as higher construction costs impact projects currently in the planning stage.

40 basis point
increase in vacancy



Vacancy:

Supply will outpace demand in 2018, applying upward pressure on vacancy in many metros across the country. The national vacancy rate will rise to 10 percent this year, which is below what the measure has averaged so far this economic cycle.

0.8% increase
in non-climate-controlled rents



Marketed Rents:

The average asking rent is expected to appreciate 0.8 percent to \$1.21 per square foot this year, building on a 1.7 percent improvement in 2017. Heavy construction is placing downward pressure on rates in many metros, inhibiting overall rent growth for the nation.

Regional Overview

West

Vacancy: The regional vacancy rate moved up 140 basis points over the past 12-month period to 5.8 percent in June. Self-storage properties on the West Coast boast some of the lowest vacancy rates in the country, above only the Midwest.

Rents: Growth in marketed rates has flattened over the past four quarters, with the average monthly rent payment remaining at \$1.61 per square foot. Certain markets have not followed the regional trend, including Seattle-Tacoma, where rents grew 4.0 percent the past year.

Prices: Self-storage properties in the West draw above-average pricing, as the regional average sale price increased 6.2 percent to \$110 per square foot over the past annual period.

Cap Rates: The West region's cap rates remain some of the lowest in the country. The average first-year return in the West remained in the low-6 percent zone after falling from the mid-6 percent range in 2016.

Mountain

Vacancy: Operations in the Mountain states remain tighter than across the nation as a whole, even as the regional vacancy rate rose 40 basis points year over year to 6.8 percent.

Rents: Asking rents stabilized over the past year, holding at an average of \$1.08 per square foot in June. This is an improvement over last year when the average fell 0.9 percent. Las Vegas is the highlight of the region in 2018, reporting an annual appreciation of 11.1 percent to \$1.00 per square foot.

Prices: Strong investor interest over limited listings has added upward pressure to prices over the past 12 months, with the average sale price increasing to \$92 per square foot.

Cap Rates: The average regional cap rate lies in the low-6 percent band, down about 10 basis points from June 2017.

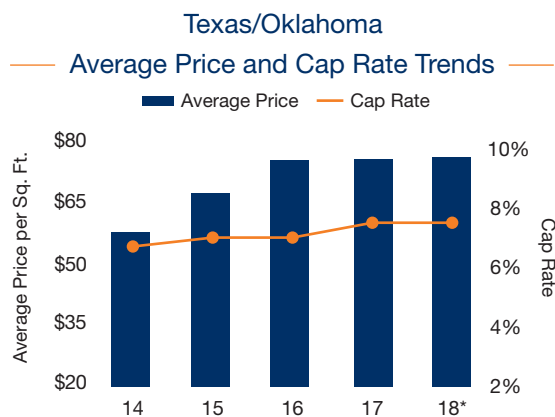
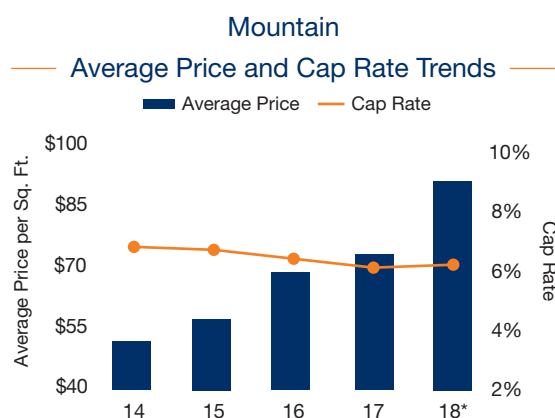
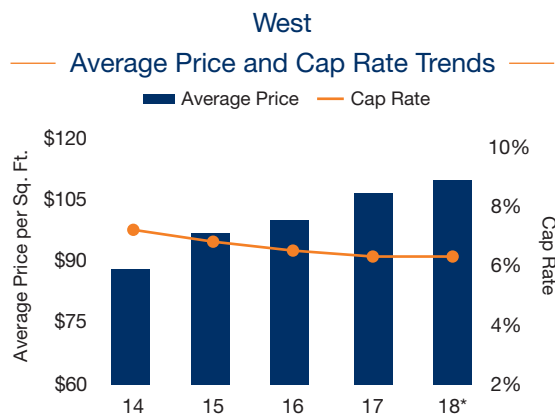
Texas/Oklahoma

Vacancy: The average vacancy rate for self-storage properties rose 30 basis points over the past 12-month period to 8.3 percent in the second quarter. Over the last annual time period, this measure jumped 130 basis points.

Rents: Extensive construction in the region has tempered rent growth as operators cut asking rates in order to lease units. As a result, the average marketed monthly rate across the two states fell 5 percent to 96 cents per square foot in the second quarter.

Prices: Transaction prices improved for the ninth consecutive year as the average sale price advanced to \$77 per square foot by the second quarter.

Cap Rates: Initial returns in the region are on average 100 basis points above the national average cap rate of mid-6 percent and have remained flat over the past two years.



* Through June 2018
Sources: Marcus & Millichap Research Services; CoStar Group, Inc.

Regional Overview

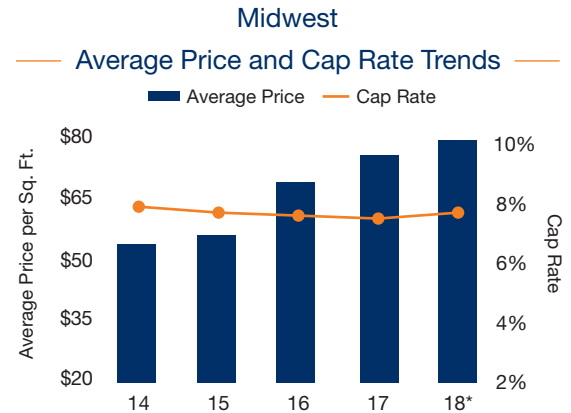
Midwest

Vacancy: The Midwest region registered the best vacancy performance of all regions over the past four quarter. The regional vacancy rate declined 60 basis points over that span to a rate of 4.5 percent. That is also the lowest vacancy rate among all six regions as well.

Rents: Self-storage operators in the region are prioritizing occupancy over rent growth during a period of elevated completions by discounting market-ed rates to fill units. The average asking rent declined 2.9 percent over the past annual period to 99 cents per square foot.

Prices: The average sale price for properties traded over the past 12 months increased 9.6 percent to \$80 per square foot.

Cap Rates: The Midwest reports some of the highest cap rates in the country with an average initial yield in the mid-7 to high-7 percent zone.



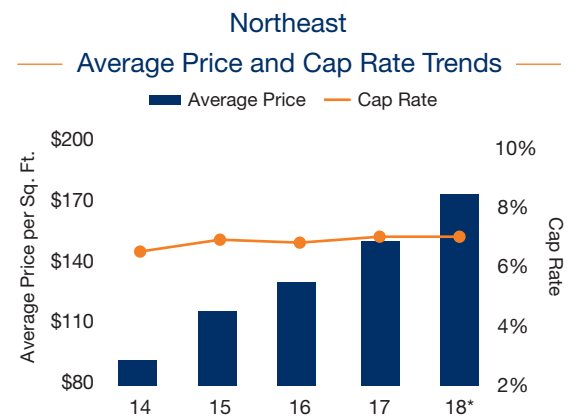
Northeast

Vacancy: Properties in the Northeast region have tighter vacancy compared with the national rate even as the regional vacancy rate increased 30 basis points to 6.6 percent year over year in June. This builds on a 40-basis-point rise from the previous annual period.

Rents: Marketed rates in the region are some of the highest in the country. The region's average monthly rent payment improved 0.6 percent over the past 12 months to \$1.59 per square foot. Rent growth was particularly robust in New York City, where the average payment appreciated 6 percent to \$2.65 per square foot.

Prices: The Northeast reports the highest prices of any other region, a fact that did not stop the average sale price from appreciating to \$175 per square foot.

Cap Rates: The region's average cap rate rose approximately 10 basis points to enter the 7 percent band in 2018. Initial yields were last this high in 2012.



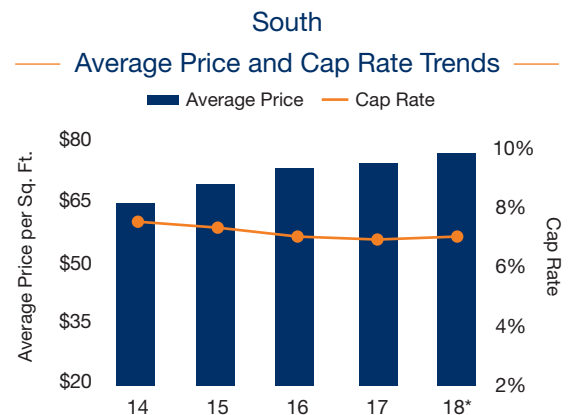
South

Vacancy: Operations among self-storage properties in the Southeastern United States remained flat at 6.5 percent over the past 12-month period.

Rents: Amid the largest construction pipeline among all six regions, downward pressure is placed on the average rental rate. Many operators are discounting asking rates in order to lease the newly opened units. The average monthly rent declined 3.4 percent year over year to \$1.13 per square foot.

Prices: Lower entry costs than in other parts of the country draw investors to the South region, where the average sale price is \$77 per square foot.

Cap Rates: Initial yields for properties traded in the region over the past year fall near 7 percent on average. The region's average cap rate has remained in the high-6 to low-7 percent zone since 2015.

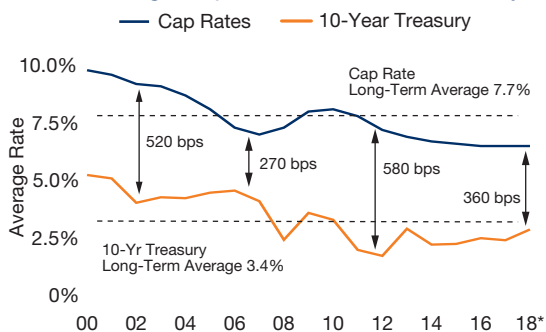


* Through June 2018
Source: Marcus & Millichap Research Services; CoStar Group, Inc.

Capital Markets

By DAVID G. SHILLINGTON, President, Marcus & Millichap Capital Corporation

Self-Storage Cap Rate vs. 10-Year Treasury



* Through July 2018

Fed tightening monetary policy. The federal funds rate remains at 1.75 percent after the Federal Reserve raised rates 25 basis points in July. The Fed noted that inflation has broadly reached its objective, while household spending and corporate investment continue to rise. Two additional hikes are expected this year, one in late September and another in December, with the potential for as many as four increases in 2019. As the Fed lifts rates, lenders are tightening margins to compete for loans. Despite these efforts, borrowing costs are rising, which may prompt investors to seek greater returns in secondary markets.

The capital markets environment remains competitive. As the Fed stays committed to tightening policy, foreign central banks have yet to remove accommodation, encouraging flows into U.S. Treasuries. Therefore, interest rates on the 10-year Treasury remain range bound near 3.0 percent. Portfolio lenders are providing debt for self-storage assets with leverage typically between 65 and 70 percent. Interest rates for five- to 10-year bank-issued loans fall in the 4.75 to 5.75 percent range. Life insurance companies have shown a willingness to outbid other financial institutions for premium assets.

2018 Metro Outlook

Metro	Vacancy	Y-O-Y Change	Asking Rents**	Y-O-Y % Change	Arrivals (sq. ft.)	Share of Inventory
Las Vegas	5.5%	50	\$0.95	-1.0%	732,000	4.2%
San Francisco/Oakland	5.7%	60	\$1.95	1.0%	550,000	1.6%
Philadelphia	6.0%	-70	\$1.19	0.0%	1,224,000	4.7%
Riverside-San Bernardino	6.0%	20	\$1.10	1.9%	374,000	1.1%
Los Angeles	6.2%	30	\$1.93	1.6%	588,000	1.6%
Phoenix	6.3%	-200	\$1.06	1.9%	2,013,000	6.6%
New York City	6.4%	-100	\$2.60	3.6%	1,802,000	7.4%
Nashville	6.7%	-160	\$1.14	-2.6%	1,714,000	15.5%
Sacramento	7.0%	-30	\$1.36	-1.4%	262,000	1.5%
Seattle-Tacoma	7.0%	50	\$1.48	-1.3%	2,151,000	7.4%

** Average marketed rent for a 10 x 10 foot, non-climate-controlled unit

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