NATIONAL REPORT

Marcus & Millichap

SELF-STORAGE

SECOND HALF 2019

Investors See Past Supply Hurdles to Strong Demand, Sustaining Sales Activity

Markets feel aftershocks of inventory growth. The self-storage construction pipeline has begun to contract following seven years of expansion, although numerous deliveries are still underway. Several markets, including Raleigh and Denver, have seen their inventories grow in excess of 40 percent so far this cycle. The added supply has placed downward pressure on asking rents, with more operators offering concessions to lease units and maintain occupancy levels. In other metros, such as Minneapolis-St. Paul and Phoenix, building is ramping up substantially in 2019, creating potential headwinds for the future. Many smaller secondary and tertiary markets are also expanding inventories at a faster pace this year. Overall building activity is moderating though, influenced by rising construction costs and tighter lending. In some cases, developers are reducing expenses by converting other types of vacant property.

Demand keeps vacancy low. While the national vacancy rate was above 14 percent before 2011, the rate has generally remained under 10 percent since 2015, despite the large amount of supply added over the past four years. Part of this is due to an evolution in how owners engage customers. Operators have made greater use of digital advertising and online portals to attract tenants, but they have also added conveniences such as automatic payment systems and 24-hour access. Looking forward, self-storage properties are poised to benefit from the aging of both the millennial and baby boomer generations. Members of the older cohort will be retiring and downsizing at the same time that many younger people will be starting families, two scenarios that are likely to lead to a greater need for storage space.

Investors pursue opportunities, aware of construction trends. While supply pressures have weighed on property fundamentals in many markets, positive demand trends and favorable yields keep buyers active. Although self-storage cap rates have compressed in recent years, softening interest rates have widened margins. Initial returns can also exceed those of other property types, further encouraging investment. Institutions are pursuing stabilized assets in the country's top metros, favoring areas with fewer completions. Private buyers continue to look for assets in the $2 million to $5 million tranche, often in suburban settings or smaller cities. The competition for quality listings has sustained the appreciation of sale prices. Interest in acquiring recently opened properties has started to decline though, as some facilities are taking longer to lease units. Overall buyer demand is strong as annual transaction velocity remained on par with last year, well above velocity levels earlier in the cycle. The Southeastern United States reported the most trades regionally over the past four quarters. Besides having a large inventory, cap rates above the national average and favorable demographic trends garner the attention of capital holders. The other region to report greater sales velocity during this span was the Northeast, where population density and pockets of rent growth appeal to investors.

2019 Self-Storage Outlook

1.3% INCREASE
in total employment

EMPLOYMENT:

Employers across the United States will create about 2.0 million new jobs in 2019, the slowest rate of growth since 2010. A sub-4 percent unemployment rate weighs on recruiters' ability to fill positions.

60 MILLION SQUARE FEET
will be completed

CONSTRUCTION:

Development moderates from last year when a record 65.8 million square feet was delivered. Total inventory will still expand by 3.9 percent in 2019, the second-highest growth rate so far this cycle.

10 BASIS POINT
increase in vacancy

VACANCY:

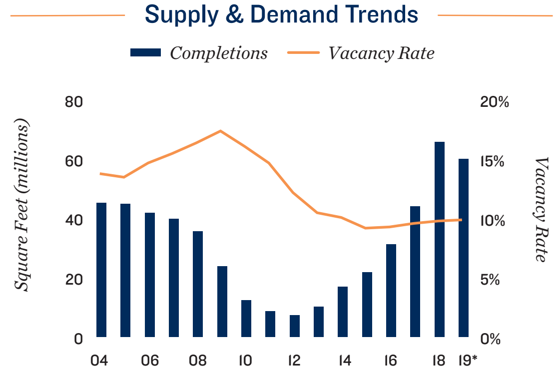
Vacancy will inch up to 9.9 percent this year, 200 basis points below the trailing 10-year average. In 2018 availability increased 20 basis points.

0.9% DECREASE
in non-climate-controlled rents

RENT:

The average marketed rent for a 10- x 10-foot, non-climate controlled unit will dip to $1.15 per square foot this year as several markets face new supply pressure.

Supply & Demand Trends

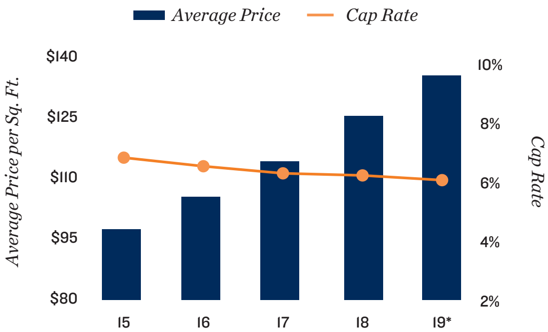


* *Forecast*

Sources: Marcus & Millichap Research Services; Yardi Matrix; Union Realtime; Bureau of Labor Statistics; U.S. Census Bureau

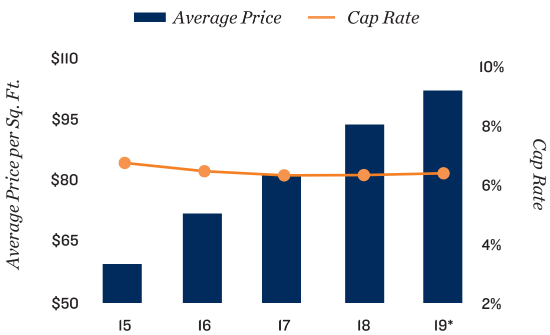
West

Average Price and Cap Rate Trends



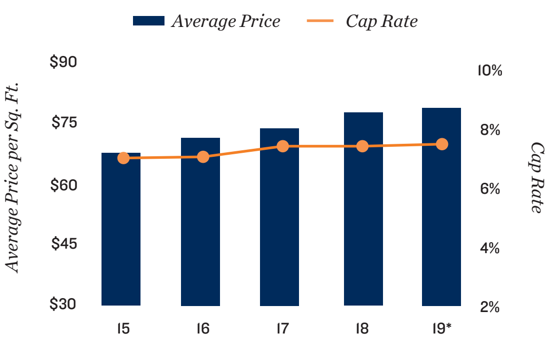
Mountain

Average Price and Cap Rate Trends



Texas/Oklahoma

Average Price and Cap Rate Trends



Regional coverage:
West: *California, Oregon and Washington*
Mountain: *Arizona, Colorado, Idaho, Montana, Nevada, New Mexico, Utah and Wyoming*

Regional Overview

West

Vacancy: Availability in the West Region rose 50 basis points year over year at the end of the second quarter to 6.8 percent, moderating from the previous annual period when the vacancy rate increased 190 basis points.

Rents: The average rent remained unchanged at $1.61 per square foot over the 12-month period ended in June as growth in some California markets was offset by declining asking rates in Northwestern metros such as Seattle and Portland.

Prices: Self-storage properties in the West continue to demonstrate strong value appreciation. The average sale price jumped 13 percent to $135 per square foot over the past annual period.

Cap Rates: The West Region has some of the lowest cap rates in the country, with the regional average dipping 20 basis points to 6.0 percent in June.

Mountain

Vacancy: The regional vacancy rate rose 20 basis points to 7.0 percent in June as availability widened in most of the major Mountain metros. Operations remain tighter than the nation's as a whole, reflecting positive demographic trends.

Rents: Rent growth was subdued across the Mountain states as the average asking rate held at $1.08 per square foot for the third consecutive year in June. Las Vegas bucked the regional trend, with rents improving 5.9 percent in that span.

Prices: Improving property fundamentals in Salt Lake City and Las Vegas contributed to the largest year-over-year sale price increase of any region. The average advanced 17 percent to $103 per square foot.

Cap Rates: The average regional cap inched up 10 basis points to 6.4 percent at the end of the second quarter, in line with the national average.

Texas/Oklahoma

Vacancy: Operations across Texas and Oklahoma tightened over the past four quarters, with the regional average down 20 basis points to 8.1 percent. A year ago, availability rose 30 basis points.

Rents: Extensive construction across the region has dampened rent growth as operators reduce marketed rates to encourage leasing. As a result, the average asking rent across the two states fell 3.2 percent to 92 cents per square foot in the second quarter. That was an improvement over the previous 12-month period when monthly payments dropped 5.9 percent.

Prices: The average sale price appreciated 4.1 percent to $79 per square foot, but entry costs remain some of the lowest in the country.

Cap Rates: The two-state region maintained an average cap rate of 7.4 percent for the third year in a row, about 100 basis points above the national average. Initial returns exceed those of any other region.

** Trailing 12 months through 2Q*
Sources: Marcus & Millichap Research Services; CoStar Group, Inc.

Regional Overview

Midwest

Vacancy: Despite a 70-basis-point increase in the Midwest vacancy rate over the past 12 months, availability remained the lowest of any region. The rate rested at 5.1 percent in June, 390 basis points under the U.S. level.

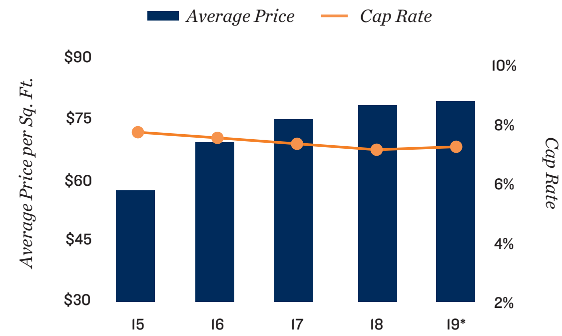
Rents: Marketed rent stayed flat over the past four quarters at an average rate of 99 cents per square foot. Rents are growing in Midwest markets with fewer completions such as Indianapolis and Cincinnati but they are contracting in Chicago. In the previous annual period, monthly rates fell an average of 2.9 percent.

Prices: The average sale price in the Midwest improved by 3.5 percent year over year to $80 per square foot, just surpassing the average for Texas/Oklahoma.

Cap Rates: The Midwest reports some of the highest initial yields in the country, with an average cap rate of 7.2 percent, unchanged from 12 months ago.

Midwest

Average Price and Cap Rate Trends



Northeast

Vacancy: New supply pressures weighed on operations in the Northeast, raising the regionwide vacancy rate 70 basis points to 7.3 percent over the 12-month period ending in June. In 2018 availability moved up 20 basis points.

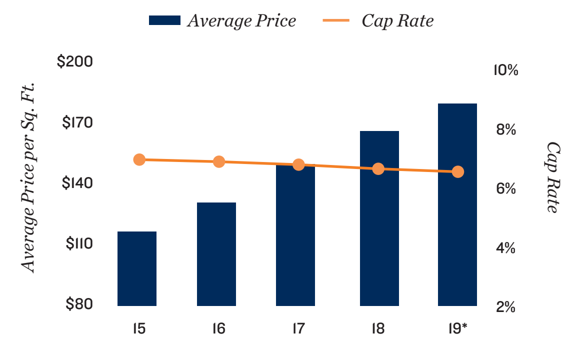
Rents: After advancing 1.9 percent over the previous annual period, asking rates dipped 0.6 percent during the past four quarters to $1.59 per square foot. The Northeast nevertheless has some of the highest rents in the country.

Prices: Buyer demand lifted transaction velocity in the Northeast Region, contributing to a 13.8 percent jump in the average sale price to $180 per square foot in June. Entry costs here are some of the highest in the U.S.

Cap Rates: In conjunction with rising sales prices, the region's average cap rate declined 20 basis points to 6.5 percent, roughly in line with the national metric.

Northeast

Average Price and Cap Rate Trends



South

Vacancy: Availability in the South rose by a wider margin than in any other region between the second quarter of 2018 and second quarter of 2019, increasing by 110 basis points to 7.5 percent.

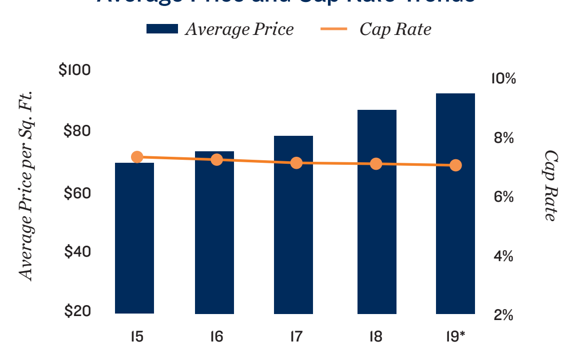
Rents: Substantial development activity in the region has added downward pressure to marketed rents, especially among the larger Florida and Carolina markets as well as in Nashville. The regional average rate declined 1.8 percent to $1.11 per square foot year over year in June.

Prices: Transaction prices improved for the eighth consecutive year as the average sale price appreciated by 11.6 percent to $93 per square foot. Lower entry costs compared with the Northeast, West and Midwest regions and favorable long-term demographic trends drove investor interest.

Cap Rates: The region's average cap rate dipped 10 basis points to 7.0 percent in June. Initial returns have averaged in the low-7 percent zone since 2015.

South

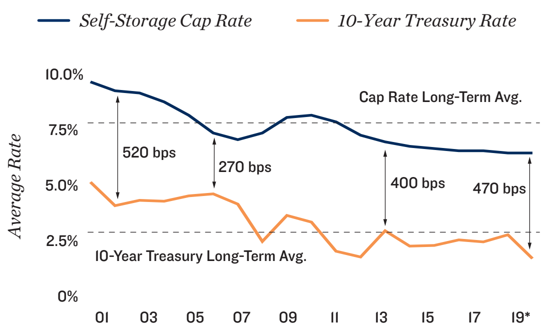
Average Price and Cap Rate Trends



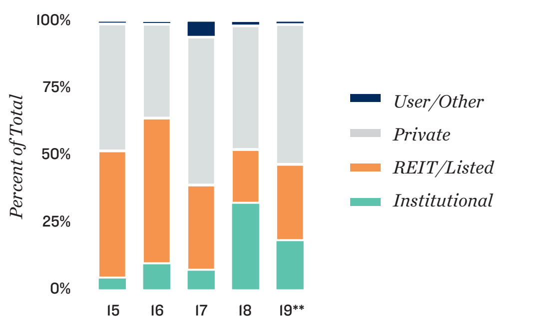
Regional coverage:
Midwest: *Illinois, Indiana, Iowa, Kansas, Michigan, Minnesota, Montana, Nebraska, North Dakota, South Dakota, Ohio and Wisconsin*
Northeast: *Connecticut, Delaware, Maine, Maryland, Massachusetts, New Hampshire, New Jersey, New York, Pennsylvania, Rhode Island, Vermont and Washington, D.C.*
South: *Alabama, Arkansas, Florida, Georgia, Kentucky, Louisiana, Mississippi, North Carolina, South Carolina, Tennessee, Virginia and West Virginia*

** Trailing 12 months through 2Q*
Sources: Marcus & Millichap Research Services; CoStar Group, Inc.

U.S. Self-Storage Cap Rate Trends



Self-Storage Buyer Composition



** Treasury rate as of Aug. 12; Cap rate through 2Q*
*** Year-to-date as of Aug. 12*
Sources: Marcus & Millichap Research Services; CoStar Group, Inc.; Real Capital Analytics; Federal Reserve Bank of St. Louis

CAPITAL MARKETS

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

- **Fed trying to extend economic runway but hitting headwinds.** The Federal Reserve's decisive action, including its rate drop in July, will support the economic growth cycle but may be outweighed by the escalating trade war. Uncertainty and caution increased following the Aug. 1 announcement that additional tariffs would be levied, sparking a flight to safety and the recent inversion of the 10-year and two-year Treasurys. Though the Fed's 25-basis-point reduction of the overnight rate and early end to quantitative tightening could pose some inflationary risk, the Fed has communicated a willingness to let the economy "run hot" in an effort to spur growth. Should core inflation rise above 2 percent, it will not be seen as an immediate risk. Falling interest rates, a byproduct of the trade war and the Fed's efforts to boost the economy, will bolster leveraged yields for investors by a small degree as lenders also look to widen spreads. With the yield on the 10-year Treasury now down 70 basis points from the cycle peak last October and recently touching its lowest level since the record low set in 2016, investment options that may not have penciled even in the second quarter may now be feasible. This should help moderate the buyer/seller expectation gap that widened earlier in the year.

- **Accessible liquidity balances conservative underwriting.** Liquidity in the lending market remains readily available for self-storage assets, with a wide range of local, regional and national banks; insurance companies; and CMBS sources still active. Many of these organizations have mildly reduced or maintained lending rates in response to the falling interest rate climate, with some instituting rate floors. While market forces are allowing assets to be readily financed, softened property fundamentals have increased lender caution, particularly for non-stabilized assets. Fluctuations in rental rates have made it difficult for some investors to estimate income growth for recently opened facilities. Conversely, lending for stabilized properties in good locations remains plentiful, underpinned by favorable storage demand metrics that include both pro- and counter-cyclical drivers such as employment growth and elevated divorce rates.

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