

NUNEZ SELF STORAGE REPORT

Volume 9 | FALL 2022

Introduction

Welcome to the Nunez Report and Fall 2022 Newsletter dedicated to the Self Storage Industry.

Headwinds. After the recent 75-basis point rate hike by the Fed, the Fed Funds Rate now stands at a range from 3.0% to 3.25% and economic forecasters are starting to predict the Fed won't stop until it gets to 4+% and perhaps 5% or even higher. Commercial paper is heading for 6% and likely higher by 1Q2023. The Fed has called out housing as the biggest inflationary element to the economy and appears dead set on bringing the housing market to a crawl. It's beginning to work. Home sales are down for the seventh consecutive month.

Even so, the Self Storage industry hums along, albeit with its guard up. Monetary pressure will likely slow new development deals and the cost of money is having other impacts on the Self Storage industry yet as you will read in our fall newsletter, there is reason for longer-term optimism.

Industry Overview

The rapid rise of interest rates has had an equally sudden chilling effect on property markets, foremost in residential real estate yet commercial real estate is not going unscathed, including Self Storage. Interest rate increases have caused

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some re-trading activity in the Self Storage sector, as Cap Rates climb 25, 50 and even 100 basis points (the latter for smaller assets), sellers and buyers have to reset their pricing expectations. Recession fears as well as inflation and the continual movement of interest rates have put many Self Storage transactions on hold for now. However, some deals are still getting done. Lenders as well as buyers are being much more cautious in their underwriting. 1031 Exchange buyers are the best opportunities for sellers with value-add

properties that can offer buyers future upside. Bear in mind any Cap Rate increase is from the ultra-low and current national average of 4%, which fell from the mid-5s before the pandemic. After all, we just emerged from a record-setting sales environment for most of the property market asset classes, including Self Storage.

However, despite the volatile economy and a shifting market, the Self Storage industry remains healthy overall.

Occupancy rates among the national Self Storage REITs are all in the mid-90s. Through the second quarter this year, occupancy for Public Storage was 94.8%, it was 95.9% for Extra Space Storage, 95.3% for CubeSmart, 94% for Life Storage and 95.2% at National Storage Affiliates. Year-over-Year (YoY) revenue growth was solid, with Public Storage enjoying 15.9%, Extra Space 21.7%, CubeSmart 14%, Life Storage 18.9% and National Storage Affiliates at 14.6%.

The average asking rent for a standard 10 x 10 storage unit increased approximately 15% from late 2021 to mid-year 2022. Average asking rents are the highest in Texas and the Southwest and projected to surpass \$1.30 per-square-foot by year end.

Self Storage developers went on a building spree beginning in 2016 and by 2019, the industry struggled to absorb all the new supply. Covid-19 changed everything, as people cleared out homes and garages to make way for more living space in their homes, the Great Migration commenced, and then there was the usual drivers for Self Storage demand – the four Ds of divorce, downsizing, displacement and death. According to a recent survey conducted by RentCafe of 4,200 renters, 21% of that group currently occupy Self Storage units and another 12% said they plan to in the near future.

Fast-forward to this year, and new supply – or Self Storage under construction or planned as a percentage of inventory, as of May ranged from a high of 19.6% in New York to a low of 3.3% in Houston among the top 31 U.S. metro areas. The national average increase was 9.7% and Phoenix ranked sixth, at 12.5%, according to Yardi Matrix.

Sales activity in the Self Storage sector was strong through mid-year, yet started showing signs of tapering from the hyper-active year 2021, when prices soared by 66%, according to Green Street Advisors.

In the second quarter this year, Life Storage acquired 13 Self Storage properties for a total purchase price of \$262 million, with assets in Florida, New York, California, Texas, Georgia and Massachusetts. National Storage Affiliates acquired eight Self Storage properties with an investment totaling \$114 million in the second quarter. Through a joint venture, the company purchased another seven properties in the Greater Houston Metro Area for \$207 million.

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Arizona Activity

Migration to Arizona is ongoing yet it feels like it is slowing. Our region's housing prices have experienced some of the greatest increases and while not anywhere close to reaching a point of diminishing return for migrants from California, residential real estate – along with lifestyle choice, are usually the leading factors in relocation. That said – factoid: from 2016 through 2020 Arizona received a total influx of migrants from all 50 states with 268,461, according to azeconomy.org, of which over 64,000 were from California. An additional 40,000 moved to the Phoenix area and over 7,000 to Tucson from the other 49 states.

Among other things, the onset of a global pandemic spurred more Americans to the great outdoors and with few options for travel in 2020 and 2021, Americans bought RVs in record numbers.

Recreational Vehicle (RV) manufacturers shipped 29,647 new RVs to customers in July of this year, bringing the year-to-date total to 353,478, according to the Recreational Vehicle Industry Association (RVIA). While that was a decline for the month of July compared with July 2021, through July this year RV makers shipped 2.5% more units than year-to-date figures from 2021.

As such, we are seeing more inquiries for RV storage facilities – which are often offered or developed with Self Storage facilities – because the two are symbiotic property uses.

New Construction Phoenix Metro & Tucson

Here's a snapshot of new Self Storage facilities planned and under construction:

- New Facilities under construction: 30 (compared with 34 in the spring and 43 last fall)
- Expansions under construction: 3 (compared with 2 in the spring and 4 last fall)
- Proposed expansions 16
- Proposed New Facilities: proposed 60 (compared with 57 in the spring and 44 last fall)

Financing as well as construction costs have certainly had an impact with many deals near permit-ready status being placed on hold or being sold. And while we might think that many have backed off of new developments all together, it appears that there is a continued focus on finding new sites. Minus a crystal ball, however, there remains a very good chance that by the time some of these locations get re-zoned and to the level of permit ready, we may be in a different economic environment ripe for new product to come online.

The Arizona Economy

The Arizona economy remains vibrant by all metrics save one, and that is inflation. Phoenix was ranked #1 among major U.S. metro markets for the highest inflation rate in August, at 13%. Otherwise, the mid-summer unemployment rate was 3.3% – a 33% decline from a year earlier and lower than the 3.7% national unemployment number. The state's housing prices were 28.7% higher than a year earlier, retail sales increased 8.7% in a 12-month span. Arizona added over 3,000 non-farm jobs in July, which was 3.5% better than a year earlier. Consistent with the current correction in the housing market, housing permits fell 7.2% from a year earlier, yet even so builders pulled 5,509 permits for new residential units in July, according to azeconomy.org.

Arizona's economic development engines are not sitting idly by, waiting for recession. According to the Arizona Commerce Authority (ACA) in a recent presentation by the group, there are currently 267 projects in the 2023 pipeline of companies seriously looking at coming to Arizona. Of those projects, 187 are manufacturing companies looking to reshore its production from other countries or foreign-based companies looking at Foreign Direct Investment (FDI) projects in the state. Moreover, there are 16 corporate headquarters looking at Arizona for their offices. The balance are technology companies, business & financial services and bioscience & healthcare group.

In addition to the work that ACA is doing, they are partnering with seven other states in NSER (National Semiconductor Economic Roadmap) to attract and grow the semi-conductor businesses in our region.

Questions?

Contact the Nunez Self Storage Investment Group for a free valuation and market analysis of your property.

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