

Newmark Self-Storage Investor Survey: First Quarter 2021

Cap Rate Compression Likely To Continue **BY CHRIS SONNE**

The Newmark Self-storage Investor Survey for first quarter 2021 indicates cap rates for self-storage have compressed 13 basis points (bps) over the past six months to an average cap rate of 5.37 percent. This indicates a continued trend of declining cap rates in the sector, as our third quarter survey indicated a 10-bps decline.

Due to strong operational and investment performance during the pandemic, new capital continues to store capital in the sector. Low loan losses, outperforming CORE CRE, has led to an abundance of debt facilities at wide availability. The public markets (self-storage REITs) continue to outperform alternative investments.

At the KeyBanc Self Storage Investor Survey on Jan. 7, 2021, Todd M. Thomas, CFA, summarized market sentiment as tailwinds for the sector, including unseasonably strong demand and a blistering pace of investment activity to continue in 2021 due to the low cost of debt and portfolio transactions in the sector were over \$3.5 billion in 2020, the highest total volume since 2016. New players to self-storage include Blackstone in a \$1.2 billion, 100-portfolio acquisition and Cascade (Bill Gates investments) investing equity into StorageMart, one of the largest private operators in the U.S. and Canada (124 U.S. and 236 worldwide) with an enterprise value stated at \$2.7 billion. Both transactions reportedly reflect a cap rate in the mid-4s. This portfolio volume underscores institutional market confidence in the sector compared to other CRE sectors. While single asset volume was down approximately one-third on the year, market

sentiment is that volume will exceed a typical year in 2021. Optimistic market sentiment is reflected in our Key Indicators Table below.

How Low Can Cap Rates Go?
SmartStop CEO H. Michael Schwartz

asked how low can self-storage cap rates go? With the rise in Treasuries in the first quarter of 2021, the spread has returned to near normal at 385 bps (compared to a 10-year average of 375 bps). But that doesn't necessarily mean the party is over. If multifamily is an indicator, cap

Low loan losses, outperforming CORE CRE, has led to an abundance of debt facilities at wide availability. The public markets (self-storage REITs) continue to outperform alternative investments.

Segmentation by Investment Quality - 1Q 2021

	Class A	Class B	Class C
Discount Rate (IRR)			
Range:	6.75% - 8.00%	7.50% - 9.00%	8.5% - 10.75%
Average:	7.85%	8.55%	9.35%
Capitalization Rate			
Range:	4.25% - 5.25%	5.00% - 5.75%	5.75% - 8.00%
Average:	4.90%	5.50%	6.25%
Terminal Capitalization Rate			
Range:	4.75% - 5.50%	5.50% - 6.50%	6.50% - 8.75%
Average:	5.12%	5.75%	6.60%

Source: Newmark Self Storage Investor Survey, 1Q 2021

rates can compress to zero dividends. The following charts illustrate a current cap rate dividend of five percent and a potential cap rate with zero dividend as seen at the bottom of this page.

I'm not suggesting cap rates will compress to 3.61 percent in self-storage, but it does indicate cap rate compression is likely to continue in 2021. Ben Vestal, president of Argus Real Estate, says, "Cap rates will continue to compress this year

rate of growth of the NOI to be the significant determinant in the yield rate: $Ro + CR = IRR$. In appreciating markets, this has resulted in a 60 percent weighting of the cash flow to reversion (or appreciation) and 40 percent to cash flow. Self-storage IRR's have been significantly higher than CORE sectors as a result. As self-storage is increasingly considered a CORE asset, cash flow models are changing albeit in less than 15 percent of respondents. Some are modeling a lower spread than

The self-storage team at Newmark Valuation & Advisory surveyed market participants about a wide variety of data points including the usual cap rate, yield rate, and growth rates. Survey participants include buyers, brokers, owners (small and large operators including REITs, national, and regional owners), investors, lenders, and REIT analysts. Most interviews were by telephone or electronic conferencing. Survey research interviews referenced

IRR data captured in our survey reflect stabilized cash flows looking forward with a 10-year typical holding period. But what about un-stabilized assets still in absorption phase? Is there greater risk now, or later forecasting a stable cash flow in the future?

largely due to the improving fundamentals and performance in the sector. We also believe that inflationary pressure is pushing cap rates lower as many buyers today are hyper-focused on cost basis, the self-storage business model, and granularity of the rent rolls. The short-term leases are setting owners up well as an inflationary hedge, as owners/operators will be able to react quickly to a changing market and much faster than other asset types."

Discounted Cash Flow Modeling

Like cap rates, discount rates or internal rates of return (IRR) also compressed in the first quarter of 2021. Historically, we have seen the spread of the compound

the growth rate by 100 bps to the IRR, but then increasing the terminal cap rate 100 bps, resulting in similar overall weighting of the cash flow and the same price/value conclusion.

IRR data captured in our survey reflect stabilized cash flows looking forward with a 10-year typical holding period. But what about un-stabilized assets still in absorption phase? Is there greater risk now, or later forecasting a stable cash flow in the future? Thought leaders in valuation suggest the farther into the future, the greater risk, suggesting an IRR of un-stabilized cash flows now should be less than a future projection of stabilized cash flows.

in this report occurred primarily in the first quarter of 2021. Additional information includes trade area size, absorption time, marketing time, profit on costs, optimism index, and other metrics. Over 50 market participants were interviewed, bolstered by anecdotal insights gained from a record number of calls with key market participants. Survey results are summarized and compared to 10 years of data in the Self-Storage Time Series – Survey Research chart as seen on the opposite page.

Chris Sonne is the executive vice president of the Newmark Valuation & Advisory Group.

Band of Investment		Band of Investment	
Mortgage and Equity Assumptions		Mortgage and Equity Assumptions	
Loan to Value Ratio	65%	Loan to Value Ratio	65%
Interest Rate	3.75%	Interest Rate	3.75%
Amortization (Years)	30	Amortization (Years)	30
Mortgage Constant	5.56%	Mortgage Constant	5.56%
Equity Ratio	35%	Equity Ratio	35%
Equity Dividend Rate	5.05%	Equity Dividend Rate	0.00%
Weighted Average of Mortgage Equity Requirements		Weighted Average of Mortgage Equity Requirements	
Mortgage Requirement	65% x 5.56% = 3.61%	Mortgage Requirement	65% x 5.56% = 3.61%
Equity Requirement	35% x 5.05% = 1.77%	Equity Requirement	35% x 0.00% = 0.00%
Indicated Capitalization Rate (Rounded)	5.38%	Indicated Capitalization Rate (Rounded)	3.61%

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Self Storage Time Series - Survey Research
1Q 2021

	3Q 2020	3Q 2019	3Q 2018	3Q 2017	3Q 2016	2015	2014	2013	2012	2011	2010	2009
Trade Area (Miles)												
Range:	1.00 - 5.00	1.00 - 5.00	1.00 - 5.00	1.00 - 5.00	1.00 - 5.00	1.00 - 5.00	1.00 - 5.00	1.00 - 5.00	1.00 - 5.00	1.00 - 5.00	1.00 - 5.00	1.00 - 5.00
Average:	3.26	3.20	3.18	3.14	3.25	3.20	3.30	3.25	3.22	3.20	3.15	3.21
Change:	0.31%	1.56%	1.27%	-3.38%	1.56%	-3.03%	1.54%	0.93%	0.63%	1.59%	-1.87%	1.23%
Demand (\$F per Person)												
Range:	2 - 8.5	2 - 8.5	2 - 8	2 - 8	2 - 8	1 - 8	1 - 8	1 - 8	1 - 8	1 - 8	1 - 8	1 - 8
Average:	7.4	7.5	7.1	6.9	7	7.1	7.1	7.35	7.31	7.15	6.98	6.73
Change:	1.37%	-2.67%	2.90%	-1.43%	-1.41%	No Change	-3.40%	0.55%	2.24%	2.44%	3.71%	3.22%
Capitalization Rate												
Range:	4.25% - 8.00%	4.50% - 8.50%	4.50% - 8.50%	4.75% - 8.50%	4.90% - 8.00%	5.00% - 8.25%	5.25% - 8.50%	5.50% - 8.50%	6.25% - 8.50%	6.50% - 8.75%	7.00% - 9.50%	7.00% - 10.00%
Average:	5.37%	5.50%	5.68%	5.60%	5.64%	5.74%	5.90%	6.25%	6.75%	7.30%	7.75%	8.75%
Change:	-13	-8	8	-4	-10	-16	-35	-50	-55	-45	-100	75
Absorption Time (Months)												
Range:	18 - 48 Months	18 - 36 Months	18 - 36 Months	18 - 36 Months	18 - 36 Months	18 - 36 Months	18 - 36 Months	18 - 36 Months	20 - 40 Months	24 - 40 Months	24 - 48 Months	24 - 48 Months
Average:	34	36	30	29	27	28	28	30	33	36	35	34
Change:	-2.0	4.0	2.0	2.0	-1.0	No Change	-2.0	-3.0	-3.0	1.0	1.0	1.0
Marketing Time (Months)												
Range:	2 - 6 Months	2 - 6 Months	2 - 6 Months	2 - 6 Months	2 - 6 Months	2 - 6 Months	2 - 6 Months	2 - 7 Months	3 - 6 Months	3 - 9 Months	3 - 9 Months	3 - 12 Months
Average:	4.0	4.4	4.2	3.7	4.0	3.5	3.0	3.0	3.0	4.0	5.0	11.0
Change:	-2.0	1.6	0.2	-0.3	0.5	0.5	No Change	No Change	-1.0	-1.0	-6.0	4.5
Profit (on Cost Only)												
Range:	15% - 35%	15% - 50%	15% - 50%	15% - 50%	15% - 50%	10% - 25%	10% - 25%	10% - 25%	10% - 25%	10% - 20%	10% - 15%	10% - 20%
Average:	25.00%	25.00%	24.00%	23.00%	25.00%	21.00%	21.00%	20.00%	17.50%	15.00%	12.50%	14.96%
Change:	-3.85%	4.00%	4.17%	-8.00%	19.05%	No Change	5.00%	14.29%	16.67%	20.00%	-16.44%	-5.67%
Optimism Index (1-10)												
Range:	6.50 - 10.00	5.00 - 9.00	5.00 - 9.00	5.00 - 9.00	5.00 - 9.00	3.00 - 9.00	3.00 - 9.00	3.00 - 9.00	3.00 - 10.00	3.00 - 9.00	5.00 - 9.00	5.00 - 9.00
Average:	8.2	7.7	7.1	6.9	8	8.1	8.1	7.5	7.25	7	6.15	5.5
Change:	6.49%	2.67%	2.90%	-13.75%	-1.23%	No Change	8.00%	3.45%	3.57%	13.82%	11.82%	-8.33%
Market Conditions												
Undersupplied:	27%	27%	28%	27%	39%	42%	42%	25%	20%	15%	10%	10%
Oversupplied:	28%	31%	32%	28%	21%	20%	20%	30%	40%	50%	60%	65%
Equilibrium:	45%	40%	40%	45%	38%	38%	38%	45%	40%	35%	30%	25%
Strategy												
Buy:	51%	44%	37%	36%	43%	55%	55%	52%	47%	42%	40%	20%
Sell:	35%	40%	42%	38%	24%	20%	20%	24%	35%	41%	45%	60%
Build:	14%	16%	21%	26%	33%	25%	25%	24%	18%	17%	15%	20%
Discounted Cash Flow												
Usage:	90%	86%	82%	81	75	70	70	61	52	41	33	36
Holding Period:	10 Years	10 Years	10 Years	10 Years	10 Years	10 Years	10 Years	10 Years	10 Years	10 Years	10 Years	10 Years
Cost of Sales:	2.0%	2.0%	2.0%	2.0%	1.8%	2.0%	2.0%	2.0%	2.8%	3.5%	4.0%	4.0%
Discount Rate (IRR)												
Range:	6.75% - 10.75%	6.50% - 11.00%	7.50% - 11.00%	7.75% - 10.75%	7.75% - 10.75%	8.00% - 10.75%	8.00% - 11.00%	8.25% - 11.00%	9.00% - 11.50%	9.50% - 11.50%	10.00% - 12.00%	10.00% - 12.00%
Average:	8.39%	8.45%	8.73%	8.75%	8.63%	8.75%	9.00%	9.25%	10.25%	10.50%	11.25%	11.50%
Change (Basis Points):	-6	-10	-2	12	-12	-25	-25	-100	-25	-75	-25	75
Rental Growth Rate												
Range:	3.00% - 6.00%	3.00% - 6.00%	3.00% - 6.00%	3.00% - 6.00%	3.00% - 6.00%	3.00% - 6.00%	3.00% - 6.00%	3.00% - 6.00%	3.00% - 6.00%	1.00% - 5.00%	1.00% - 5.00%	1.00% - 5.00%
Average:	3.50%	3.25%	3.50%	3.50%	3.55%	3.60%	3.50%	3.25%	3.50%	3.25%	3.50%	3.00%
Change (Basis Points):	25	-15	-10	-5	-5	10	25	-25	25	-25	50	50
Expense Growth Rate												
Range:	2.00% - 5.00%	2.00% - 5.00%	2.00% - 5.00%	2.00% - 5.00%	2.00% - 5.00%	2.00% - 5.00%	2.00% - 5.00%	2.00% - 5.00%	2.00% - 5.00%	2.00% - 5.00%	2.00% - 5.00%	2.00% - 5.00%
Average:	3.00%	3.05%	3.10%	3.02%	3.01%	2.94%	3.00%	3.00%	3.25%	3.00%	3.00%	3.00%
Change (Basis Points):	-5	-5	-2	1	7	-6	No Change	-25	25	No Change	No Change	No Change
Terminal Cap Rate												
Range:	4.75% - 8.75%	4.75% - 8.75%	4.75% - 8.75%	5.00% - 8.30%	5.20% - 8.20%	5.25% - 8.25%	5.50% - 8.50%	6.00% - 8.50%	6.50% - 8.75%	7.00% - 9.00%	8.00% - 10.50%	8.00% - 10.50%
Average:	5.63%	5.85%	5.92%	5.86%	5.88%	6.01%	6.15%	6.50%	7.00%	7.50%	9.00%	9.00%
Change (Basis Points):	-22	0	6	-2	-13	-14	-35	-50	-50	-150	No Change	50
Spread to Cap Rate (Basis Points):	26	35	25	26	24	27	25	25	25	20	125	25

Compiled by Newmark