to start looking to the future and planning for upcoming loan maturities. You should be calculating what loan amount your property will likely support based on forward-looking interest rate assumptions. There may be individual situations whereby a new loan will not provide proceeds enough to pay off existing debt.

(See Figure C)

The Fed is well on its way to curbing inflation while it is still uncertain if there is going to be a soft landing or recession. There may also be a lingering tightening of credit and availability of capital.

The default rate on maturing loans is likely to rise, mostly from other commercial real estate sectors, particularly in the office sector, as borrowers are unable to seek replacement debt suitable to pay off current loans. The heightened risk awareness from capital providers will likely lead to an uneven playing field where stronger borrowers and properties have access to capital while weaker properties and weaker borrowers will have fewer alternatives.

Market conditions will once again evolve as some certainty of capital costs settle in once the Fed indicates that they no longer see a need to implement additional increases to the Fed Fund rates.

None of us can predict the future, so you should be thinking about how these higher interest rates may influence your investments and how to best position yourself in the coming years. Looking ahead, we are likely to see less construction, more consolidation, and an increase in transactional volume—all ultimately greatly influenced by the Federal Reserve and its control over the Federal Funds Rate. ■

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Investor Survey 2Q 2023

Market Sentiment Remains Optimistic

BY CHRIS SONNE

Self-storage cap rates increased an average of 21 basis points in 2Q 2023 to 5.56 percent, an increase of 34 basis points since 4Q 2022 based on our quarterly Investor Survey. The self-storage team at Newmark Valuation & Advisory surveyed over 50 market participants about a wide variety of data points, including market sentiment, marketing time, and outlook. Survey participants include buyers, brokers, owners (small and large operators, including REITs, national and regional owners), investors, lenders, and REIT analysts. Most interviews were in person, by telephone, or electronic conferencing.

The 2Q 2023 data is focused primarily on overall capitalization rates, terminal capitalization rates, and discount rate (IRR). Key performance indicators are shown in the following table:

Segmentation by Investment Quality - 2Q 2023

	Class A	Class B	Class C
Discount Rate (IRR)			
Range:	6.50% - 7.50%	6.75% - 8.50%	7.50% - 9.50%
Average:	7.05%	7.80%	8.65%
Capitalization Rate			
Range:	4.5% - 5.50%	5.00% - 6.00%	6.00% - 7.75%
Average:	5.00%	5.90%	6.25%
Terminal Capitalization Rate			
Range:	5.00% - 6.25%	5.25% - 6.50%	6.25% - 8.25%
Average:	5.45%	6.40%	6.80%

Source: Newmark Self Storage Investor Survey, 2Q 2023

Sales volume of single assets has declined by over 60 percent in year-over-year analysis, with most transactions occurring at the $5 million price point or less. Yet, market sentiment remains cautiously optimistic, with the biggest concerns of sector performance not related to the asset itself but to exogenous factors such as continued tightening in lending, further Fed increases, and macro-economic conditions. Institutional investors like the self-storage asset class as indicated by the largest transaction in the history of the asset class with the merger of Extra Space Storage and Life Storage.

Self-storage is not immune to market conditions of commercial real estate but remains resilient to downward trends. Early indications of operational activity this summer indicate a slower rental season than expected or even typical of prior years. And there are concerns of acceleration in the increases of cap rates. On the other hand, supply and demand conditions are generally in balance (varies by trade area) with muted new construction. The general outlook is satisfaction with self-storage investments.

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