Self-Storage Units as an Investment Asset

I hope everyone is healthy and safe during these crazy times.

Today's Blog is regarding Investments in Self-Storage units.

Often times, investors will ask if a syndicator or fund manager has any skin in the game. My husband and I are heavily invested in the Reliant fund and there are quite a few reasons why.

Dave Zook, the CEO & Founder of The Real Asset Investor and a #1 best selling author suggested this Fund to us for 5 reasons.

Superior Returns: According to the National Association of REIT (Real Estate Investment Trusts) the Self-Storage sector produced an average of 17.43% annual returns from other REIT sectors over the same time period.

Recession Resistant: According to the NAREIT the self-storage asset class also outperformed other sectors in the most recent recession. From 2007-2009 the self-storage sector produced an average of -3.80%. For comparison, here are the returns from the other REIT sectors over that same time period.

Why was self-storage able to outperform almost every REIT sector during the most recent recession? And why is this sector somewhat insulated to the impact the recession had on other market sectors?

When the economy is good and disposable income is on the rise, people buy more "stuff' and need a place to store it. In the midst of the recession, when homeowners were losing their homes to foreclosure or downsizing to apartments, they also needed a place to put their stuff. Where do they go? Self-storage units! At the heart of this issue is the fact that Americans have a culture of buying too many things and we can't seem to get rid of most of it. The demand curve for self-storage seems to be inelastic which helps pull the sector through major downturns. Estimates are that one-third of storage space is filled with items that have been there for over three years.

Rent Growth & Positive Net Operating Income: In-place self-storage tenants are generally not price sensitive, as the self-storage rental fee is normally a small portion of a tenant's monthly $160 disposable income. This allows operations to raise rents as the market demand grows without an impact on occupancy. For example if you are paying $100 a month for your 10x10 storage unit and the rent goes up 6 % to $106 a month, most tenants are not price sensitive enough to rent a moving truck and spend a Saturday moving to another storage facility.

In addition, there is minimal communication between different tenants at a given facility, which allows for the operator to selectively adjust rental rates for individual tenants. This is one of the main reasons large self-storage operators are able to, in general, increase rental rates by 5-12% annually. We are working with a self-storage operator who experienced 12% rent growth in the 47 property portfolio across the Southeast. Consistent rent growth of 12% is far too aggressive to include in pro-forma for a self-storage investment but certainly speaks to the pricing opportunity in this asset class.

Tax Benefits of Depreciation: One of the many benefits of real estate investing, including self-storage, is depreciation - the loss in the value of a building over time due to wear and tear, deterioration and age. Depreciation can only be applied to the building, not to the land, since land does not wear out over time. Luckily for real estate investors, depreciation reduces one's reportable net income and their taxes. This depreciation is passed through to investors via their K-1 statements.

Fragmented Market: Nearly 80% of self-storage properties remain in the hands of small, independent investors. The sector's solid past performance has begun to capture the attention of large institutional investors. Larger properties in particular are increasingly the subject of interest from institutional buyers, including the larger self-storage companies that run themselves as real estate investment trusts (REITs). The top 6 public companies control approximately 18% of all the facilities with the remaining approximately 82% of the facilities controlled by independent owners. This fragmentation should provide for the opportunity for well capitalized and sophisticated operators to selectively target individual assets and portfolios at attractive cap rates. Consolidation will allow some of these operators to amass attractive portfolios of assets and emerge as large industry players. Once stabilized these portfolios become attractive assets for a REIT to purchase and create an attractive exit for investors.

The investment community has taken notice of self-storage as a viable commercial real estate asset class, and the underlying dynamics continue to fuel the sector's success. With solid recent post performance and upward trending occupancies and rental rates, self-storage represents a tremendous opportunity if purchased at the right price and with the right operator.

In Conclusion

While many of our commercial asset class peers saw a big decline in demand from 2007-2009, Self-storage demand fell by only -3.86%.

By comparison Apartment demand was down -6.72%, (Retail -12.32%) (Office -8.16%) and the S&P a whopping -21.10%.

During the last recession even when downsizing Americans did not seem to lose their appetite for Self-storage.

Self-storage also rebounded faster than any of the other commercial asset classes after the great recession and became one of the favored asset classes for Institutional buyers.

Self-storage often acts as a hedge against a downturn in the economy and can add some stability to an investor's portfolio.

References: IBISworld and Yardi Matrix:
https:llwww.yardimatrix.com/Media/Downloads/Filel269-Summer2017SelfStorageReport

Dave Zook: https://www.therealassetinvestor.com/investments/asset-class/self-storage

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