Securitized Products Special Topics

Self Storage: Aspects to Watch as Performance Decelerates

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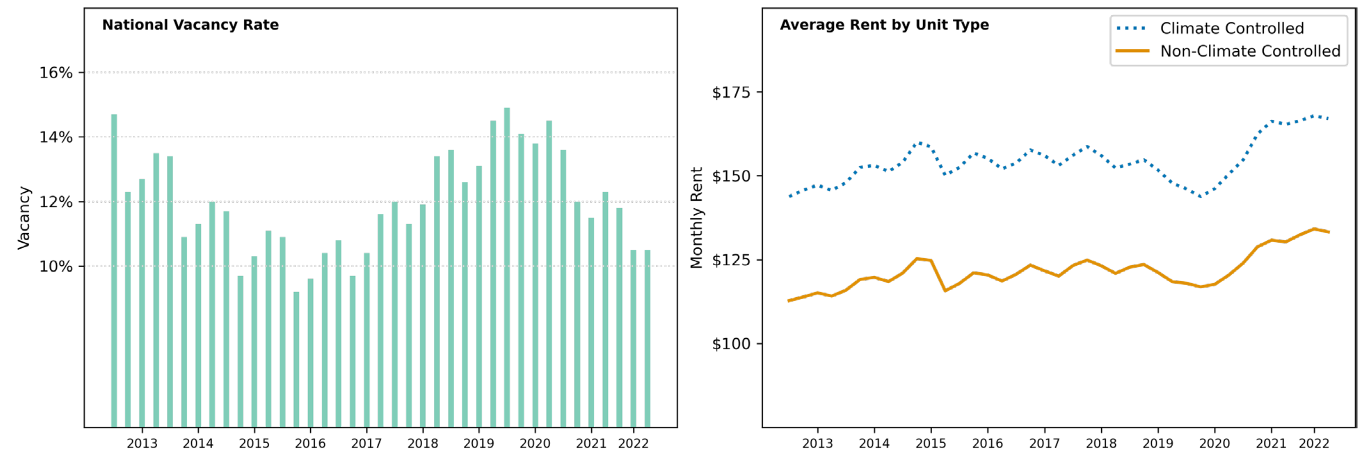
Storage Still Favorable as Property Performance May Diverge

Self-storage properties may start showing more visible performance differences, as the resilient sector softens, while still attracting growing investor interest. The self-storage national vacancy rate dropped to 10.5% in late 2022, after peaking at 14.9% in Q1 2020, according to REIS (Figure 1). The rate now appears to be leveling off. Recent self-storage rent data paint a clearer deceleration trend. Climate controlled (CC) unit rents fell 0.5% to $167.0 in Q3 2022 compared to the previous quarter. Non-climate controlled (Non-CC) rents showed a similar drop of 0.6% on a quarterly basis. Still, existing customer rate increases, rather than so-called "street" rates, should be the key performance growth driver. Self-storage customers are famously sticky. Landlords put much emphasis on customer acquisition, echoing themes in other relatively strong segments such as manufactured housing.[1] In turn, short lease durations should also insulate the storage sector to some extent from inflationary pressures. Operators may be able to adjust rents on a monthly basis.

Figure 1. National Self Storage Vacancies and Unit Rents



Source: REIS, Bloomberg and Academy Securities

[1] "Manufactured Housing: Resilient Segment Amid Potential Multifamily Softness," Securitized Products Special Topics, Academy Securities, July 27, 2022

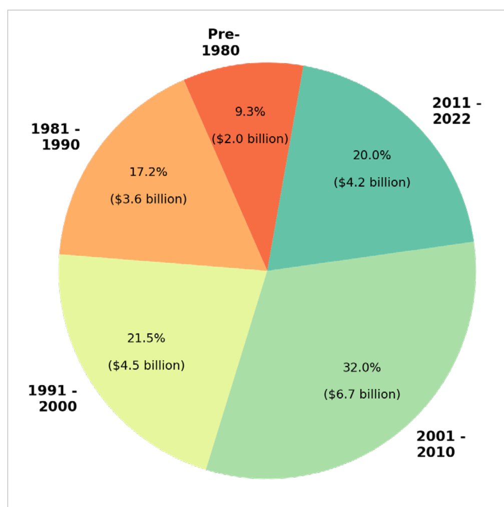
Aspects to Watch in Self Storage Loan Analysis

Weakening CMBS loans underscore aspects to watch in self-storage analysis. For example, the $41.4 million Storbox Self Storage (BACM 2017-BNK3) is currently watchlisted for vacancy issues. The 2,322-unit facility saw its occupancy dropping to the mid-60%, before apparently recovering in recent months. The Pasadena, CA, storage property was built in 1988. The operator is a relatively small, private, diversified CRE developer, according to deal documents. Property age and operator identity may be key factors driving self-storage property performance.

We suggest investors track the following aspects on self-storage loans:

- **Older properties may struggle.** Functional obsolescence can challenge older storage properties, echoing trends in other CRE sectors such as industrial.[2] The consistent, large difference between CC and Non-CC unit rents that Figure 1 showed alludes to the value customers find in modern storage units. The large, publicly traded storage REITs appear all focused on technological innovations such as facilitating digital access to units and remote property management. However, aged properties back quite a few of CMBS storage loans. About 48% of the CMBS storage exposure is to properties built before 2000 (Figure 2). For example, loans such as the $34 million Storquest – Richmond, CA, or the $25 million Storage Stables Jackson (both in BANK 2021-BN38, 8.1% combined exposure) are backed by properties built in the 1970s or 1980s, featuring mostly Non-CC units, and what appear to be dated facilities, based on deal documents. In contrast, the collateral behind the $356.5 million JPMCC 2022-NXSS SASB deal is 29-asset portfolio of newly constructed storage facilities, with CC units representing 95.7% of the square footage. To be sure, property age in and of itself may not suggest immediate credit issues. But the notable age differences across CMBS storage exposure merit investor attention.

Figure 2. Self-Storage CMBS Exposure by Property Age

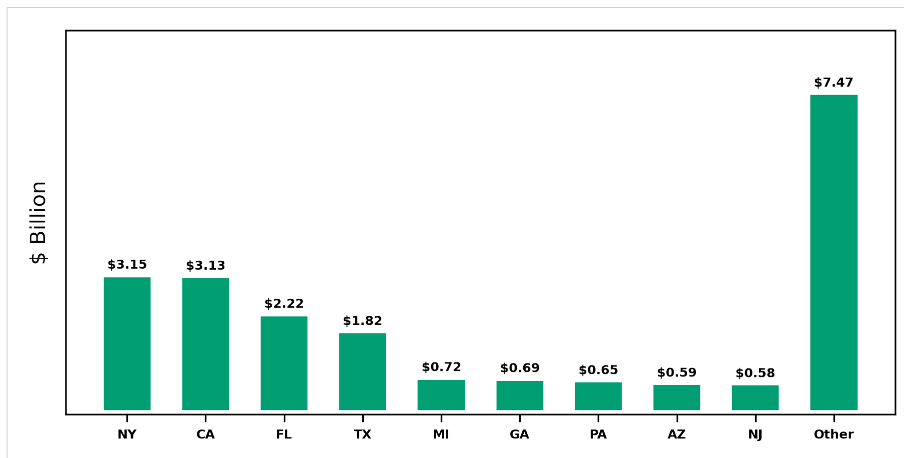


Source: MCIA and Academy Securities

[2] "Industrial Delinquencies: Don't Happen Often, but Watch Closely When They Do," CMBS Credit Focus, Academy Securities, June 1, 2022

- **Focus on under-served markets.** Markets continue to significantly differ in their storage inventory. Notably, New York state is still least supplied among states with most storage facilities. New York features only 3.0 square footage per capita availability, compared to 6.2 sf per capita on a national level, based on market presentations. Oklahoma and Texas have the most availability, at 8.7 and 8.3 sf per capita, respectively. Storage properties in markets with limited supply may perform well even as property characteristics may suggest otherwise. For example, the 18-property storage portfolio backing the $2.08 billion SMRT 2022-MINI contains some buildings constructed before World War I or in the 1920s. But the MINI portfolio is comprised of storage properties in Manhattan. This explains the unusual properties' age, and suggests the location, and the limited storage availability on the island, may be the key performance driver. CMBS exposure by state shows deals have the most exposure to New York and California facilities (Figure 3).

Figure 3. Self-Storage CMBS Exposure by State



Source: MCIA and Academy Securities

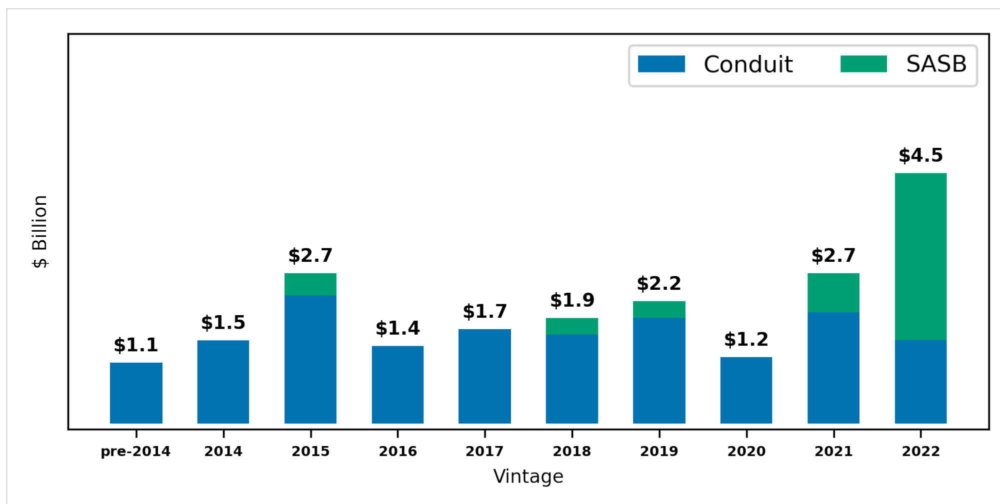
- **Pandemic may have shifted desirable locations.** The Manhattan MINI portfolio underscores not only limited supply markets, but also storage facilities that may be benefitting from urbanization trends. The relatively smaller size apartments prevalent in core urban areas are generating storage demand in such areas. Indeed, pre-pandemic we were more constructive on storage facilities in urban locations versus suburban properties, all else equal. With the pandemic upending a bit the migration of young professionals (as well as empty nesters) to urban areas and smaller apartments, the strong storage markets may be shifting as well. Now secondary markets with strong population growth, such as Nashville, Raleigh-Durham, or Charleston, SC, are seeing the strongest performance at the market level, according to Yardi Matrix data.

- **Consolidation favors large operators.** Self-storage ownership remains fragmented. Small operators own 70.6% of the facilities, according to deal documents. 96 companies hold 9.8% market share, and six publicly traded companies control the remaining 19.6% of the facilities. The large operators notably allude to industry consolidation opportunities, and acquisition activity. Extra Space Storage's acquisition of Storage Express (107 remotely managed stores, 3.8 million sf) to the tune of $590 million is one recent example. Relatedly, a notable trend in the sector is generating demand via web search and mobile devices. Operators put significant emphasis on aspects such as Search Engine Optimization ("SEO") to make sure their properties prominently appear on web search results. Customers may no longer drive around the neighborhood looking for storage facilities ("drive-by" acquisition). Such demand generation trends also give advantage to larger operators, with more robust technology platforms, and economies of scale. Anecdotally, one large operator noted it is paying on ~2+ million search keywords to promote its properties via web searches.

CMBS Self Storage Exposure Shifting to SASB

CMBS deals have about $21.0 billion outstanding exposure to self-storage properties across more than 1,900 loans (Figure 4). CMBS storage exposure has shifted from mostly conduit loans to concentrate much more heavily in SASB deals.

Figure 4. Self-Storage CMBS Exposure by State



Source: MCIA and Academy Securities

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