

Self-Storage Is a Small but High-Performing Sector



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Self-storage is a relatively new asset type in the world of institutional investment and still represents a small piece of the overall institutional investment universe. Self-storage data became available in the NCREIF database beginning in 3Q2002. At the beginning of the data, four self-storage properties worth \$183 million accounted for the dataset. But that has grown steadily over time—likely as a result of its impressive performance (Exhibit 1)—and today, there are 1,090 self-storage properties worth \$23.6 billion in the NCREIF database. To put that into perspective, 10,851 buildings are in the major sectors worth \$848 billion. So it's still a very small, niche sector.

Exhibit 1 shows that self-storage properties in the private sector have delivered consistently strong performance relative to traditional asset class sectors. In fact, of the six sectors shown in Exhibit 1, self-storage has been the best-performing sector on a trailing annual basis nearly 40% of the time and in the top two best sectors more than 80% of the time. Of the alternative sectors in NCREIF, including self-storage, student housing, assisted living, independent living, life sciences, and medical office, self-storage has outpaced the others

since consistent data began in 2017. This is true in the public sector as well, with long-term average annual total returns of 14.9% since 1993, besting the second-highest sector (manufactured housing) by a whopping 370 basis points (bps), according to Hines Research.

As with many types of niche real estate, scale is an issue. According to Hines Research and NCREIF, the average self-storage asset has a gross asset value of just \$21.7 million versus more than \$78.1 million for assets in the major sectors. Aggregating a self-storage portfolio of size takes significant effort but also provides an opportunity for alpha because there is less institutional competition.

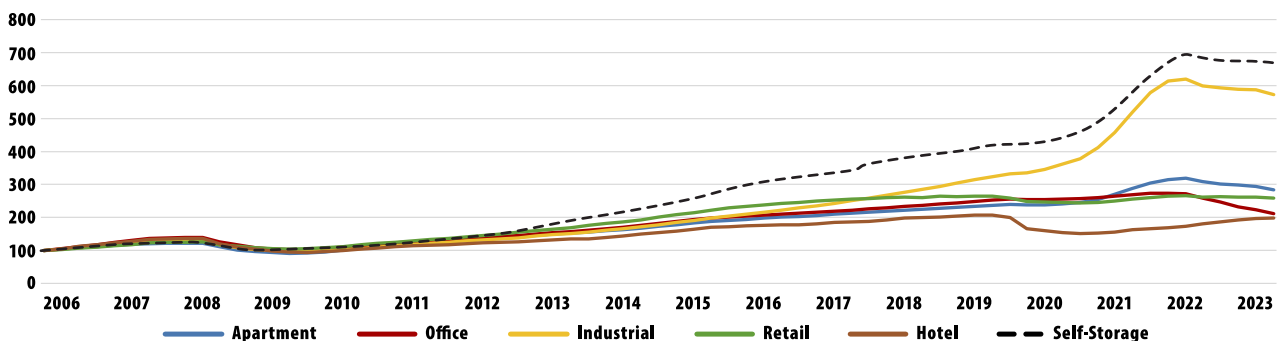
Self-storage is a bit of a larger piece of the public sector, with four companies combining for a market cap of just under \$90 billion, according to Green Street Advisors as of April 19, 2024. That market cap has grown significantly since 2002, when two public-sector self-storage companies had a market cap of \$4.8 billion. The Green Street report shows that of the four current companies, Public Storage dominates the sector, with a market cap of \$46 billion, followed by Extra Space Storage, with a market cap of \$29.4 billion.

Fundamentals

Self-storage demand is mostly driven by large life events, including downsizing, dislocation (i.e., moving), divorce, and death. The decline in home sales given the

Exhibit 1: NCREIF NPI Total Returns Versus Self-Storage (Index, 100 = 2Q2006)

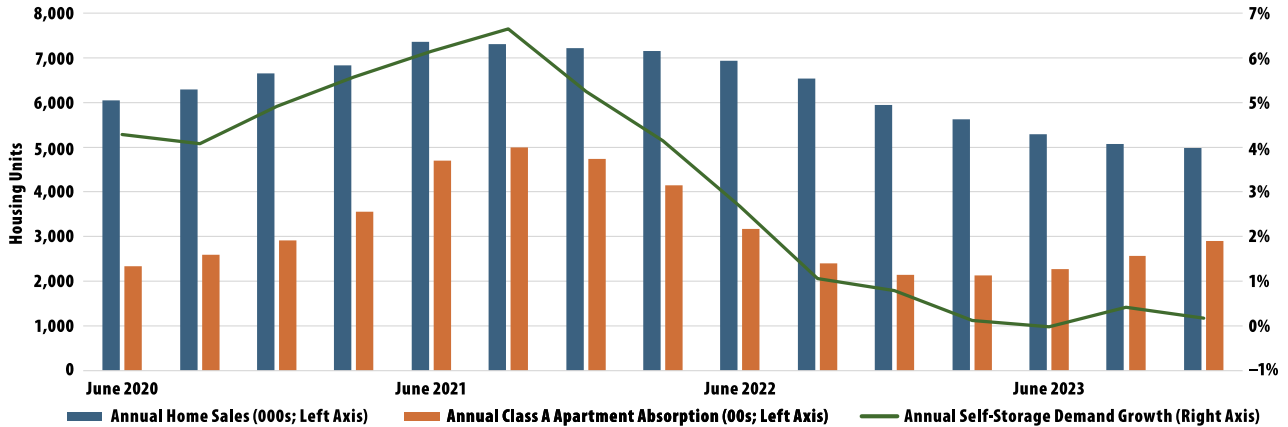
Self-storage has significantly outperformed traditional sectors.



Sources: NCREIF, Hines Research; as of 4Q2023

Exhibit 2: Home Sales, Apartment Demand, and Self-Storage Demand

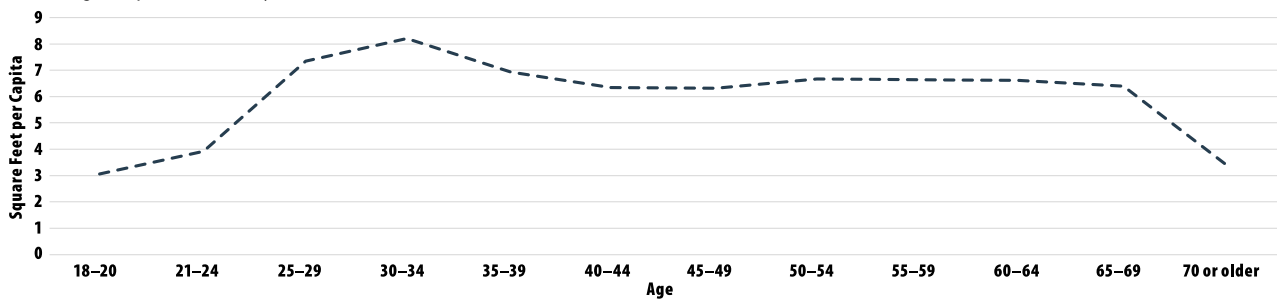
Demand for self-storage has slowed given lower household formation.



Sources: Google, Redfin, CoStar, Hines Research; as of 4Q2023

Exhibit 3: Per Capita Self-Storage Usage Across Life Cycle by Generation

Self-storage use peaks in the early 30s.



Sources: Hines Research, Green Street, CoStar; as of 4Q2023

rise in mortgage rates and the unwillingness of existing homeowners to part with their current low mortgage rates has curbed the pandemic-induced surge in mobility that drove self-storage demand in 2021–2022. As shown in Exhibit 2, as home sales and apartment absorption slowed, self-storage demand growth also did.

Like most things real estate, demographics also play a role in self-storage demand. As shown in Exhibit 3, self-storage usage peaks for people in their early 30s, declines until the early 40s, stays steady until about age 70, and then falls significantly thereafter. The industry really matured when the baby boomers entered their early 30s and utilized self-storage more than 60% more than their parents did. Every generation since has utilized the asset class more than the previous generation, according to a study by the Self Storage Association in 2023. Still, given changes in demographics expected over the next 15 years, Hines

Research projects self-storage demand growth of about 1.5% per year versus an average of more than 3% from 2010 to 2020 as millennials age into their late 30s and early 40s.

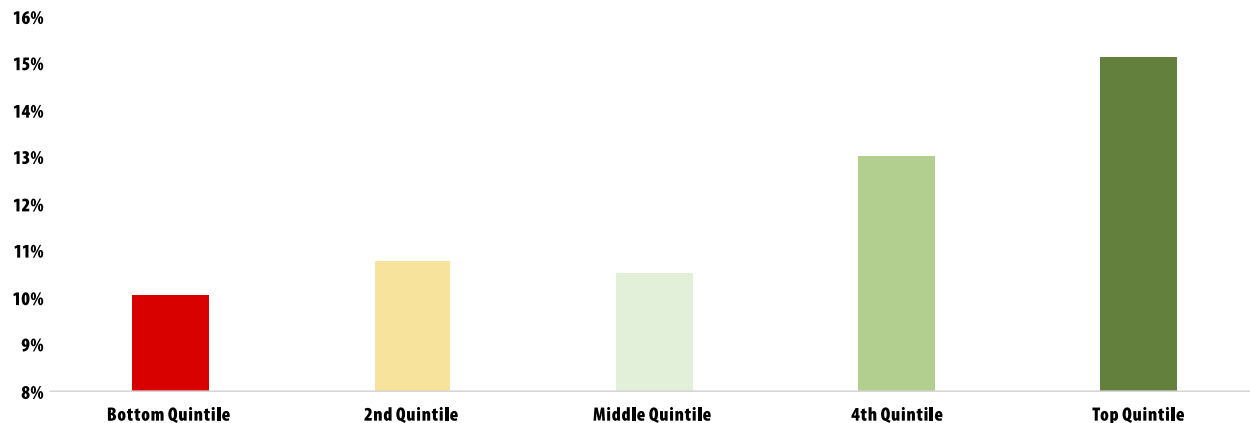
When the COVID-19 pandemic hit, the self-storage industry was in the midst of absorbing a wave of deliveries that peaked in 2018, when inventory grew by 4.8%, according to Green Street. That slowed to 2.5% in 2023 and is poised to decline further given the drop in demand growth as well as high construction and financing costs. As a result, and like other property types, a dearth of new supply in the near term should bode well for a strong recovery in fundamentals in the latter half of the decade despite a reduced demand outlook.

Getting Local

Industry data indicates that most self-storage demand is derived within 20 minutes of a home or business. To

Exhibit 4: NCREIF Annual Total Return 2000–2023

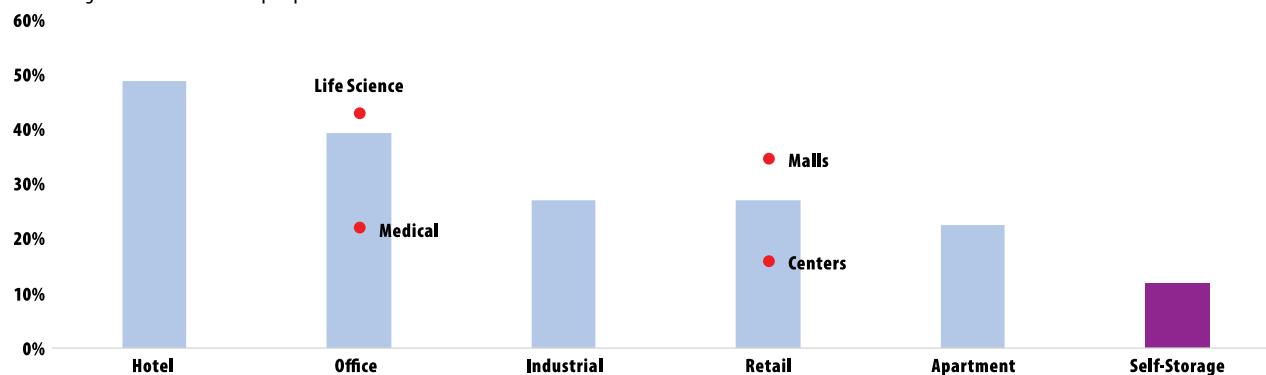
High core submarkets have historically outperformed.



Sources: Hines Research, NCREIF; as of 4Q2023

Exhibit 5: MSCI/IPD Capex as % of NOI Since 2006

Self-storage had an attractive capex profile.



Sources: MSCI/IPD, Hines Research; as of 4Q2023

assess individual locations and the prospects for income growth and total returns, Hines Research developed Self-Storage Core Scores utilizing the following methodology. First, Hines Research calculates the amount of population growth over the past decade within 20 minutes of each submarket and the amount of existing self-storage supply at the start of the decade. Hines Research estimates an obsolescence factor of existing stock per year and uses a standardized assumption for how much new self-storage space is needed per new person added to the area over the past decade. That estimate is then compared with what was built. If less was built than population growth would suggest is demanded, that area is considered somewhat supply constrained. Hines Research then regresses those results at the metro level

against long-term self-storage revenue growth and uses those results to forecast long-term revenue growth at the submarket level. Finally, that result is added to current cap rate estimates, and those results are put on a scale of 0–100 to create the core score. As shown in Exhibit 4, while self-storage has generated strong returns just about everywhere, submarkets in the top quintile—i.e., core scores in excess of 80—have produced long-term average unleveraged returns of roughly 500 bps greater than those in the bottom quintile.

NOI Growth and Capital Expenditures

Average annual same-store net operating income (NOI) growth of 6% since 2006, according to data from NCREIF, more than doubles the next-best major property sector,

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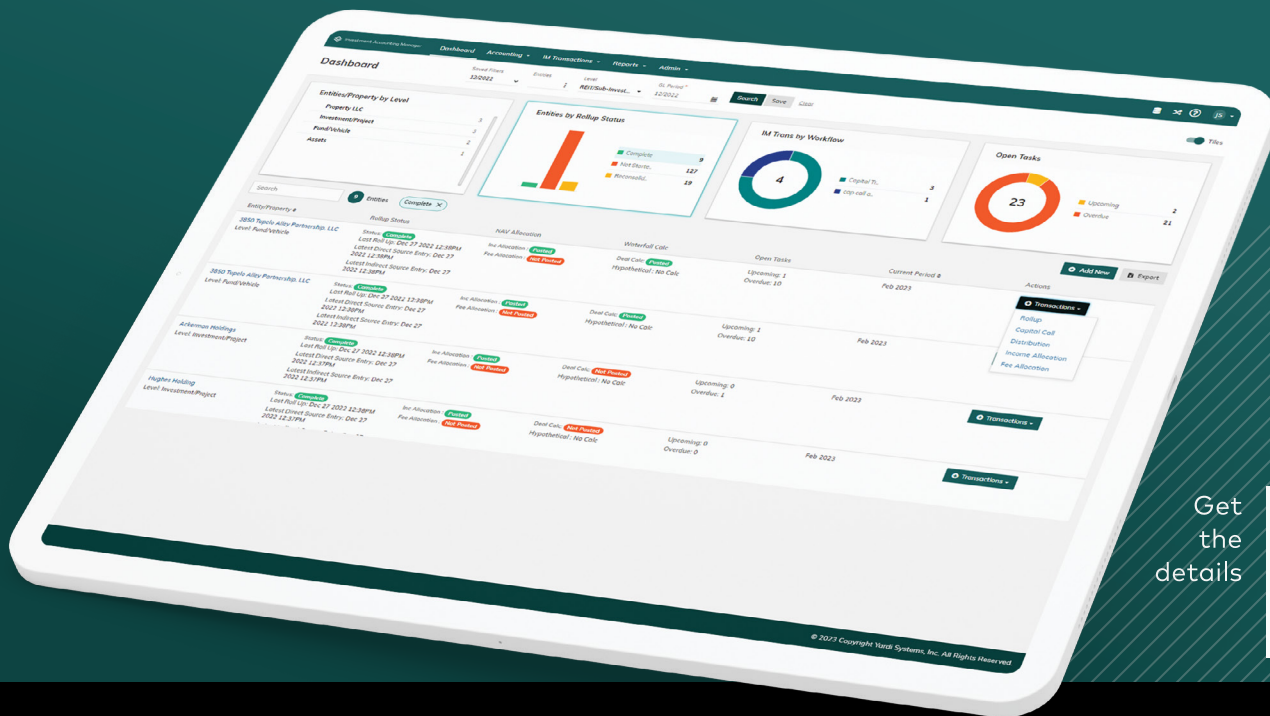


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which is apartment. In addition, given a favorable capex profile, more of that NOI is ultimately converted to cash (Exhibit 5).

Data from Green Street corroborates the historical, attractive capex profile of self-storage, with that source estimating only 8% of NOI is needed for capex, slightly below the 12% experience in NCREIF.

Capital Markets

Soft fundamentals due to the decline in demand growth as well as an overhang of new product combines poorly with higher financing costs. As a result, like most types of real estate, transaction volume has declined significantly, thereby reducing price discovery. CoStar tracked 2,404 self-storage transactions over the past year as of 1Q2024, up from a low of 2,011 in 2Q2023 but well below a cyclical peak of 3,400 in 1Q2022. Per CoStar, the median price per square foot fell to less than \$87 from a cyclical peak of just under \$118, and the median cap rate was 6.6% in 1Q2024, up from a cyclical low of 5.4% in 1Q2022. For more-institutional self-storage assets, Green Street reported a cap rate in the mid 5% range as of April 19, 2024, versus 4% at the peak of the market in 1Q2021. Within the NCREIF data, appraisal cap rates on self-storage assets were in the low 4% range as of 4Q2023 versus sub-4% at the peak of the market,

and the last transaction cap rate out of NCREIF was in 1Q2022 during the zero interest rate policy frenzy, with a reported cap rate in the mid 3% range.

Conclusion

Although going through a soft patch, self-storage has had a long run of performance with strong NOI growth and healthy occupancy rates. While it has emerged into a mature asset class in the US over the past 20 years, self-storage is in its infancy in other parts of the world, including Europe where the amount of self-storage per capita is a fraction of that in the US. Combined with an attractive capex profile, self-storage presents a compelling risk-adjusted return. Although the near-term challenge is working through soft fundamentals, the longer-term challenge is accruing enough self-storage to create an efficient large-scale platform, given its bite-size investment opportunities. ■

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