StorQuest Self-Storage - Greenwood Village, CO

The third in a series of reports from ASB on the impacts of the global pandemic on real estate investing and markets.

Self-Storage Outperformance Gains Notice During Pandemic

Self-Storage: A Core Real Estate Property Sector. COVID-19 has firmly cemented self-storage's place in the conversation about core real estate property sectors. Within the past decade, the rapid growth in self-storage inventory reflects not only strong growth in utilization among the overall population, but also strong and growing investment interest from public and private institutional investors. The sector boasts enviable attributes which have resulted in net operating income (NOI) growth with modest volatility and total returns which have exceeded each of the four major core property types for nearly 15 years. These superior investment returns have been aided by the sector's high operating margins and limited on-going capital expenditure requirements. Furthermore, superior rent roll diversification mitigates single tenant credit risk, while inelastic demand from sticky tenants and modest relative supply have helped contribute to landlord pricing power and long-term NOI growth. Although many of these attributes have been widely recognized over the past decade, the COVID-19 pandemic has highlighted the sector's recession-resistant attributes less familiar to many investors.

Recession-Resistant Attributes. Historically, self-storage's ability to deliver consistent NOI growth has been evident even during recessionary periods. When job losses occur and workers face increasing economic insecurity, mobility tends to increase as people relocate for better economic prospects or more affordable living situations. These transitioning households tend to increase demand for self-storage, a dynamic well-demonstrated during the ongoing pandemic. Millions of Americans have lost their jobs and were forced to move, or face the threat of eviction or foreclosure. In addition, young workers, overrepresented in the hardest hit occupations, saw their unemployment rate jump from 8.4% to 24.4% from spring 2019 to spring 2020.[1] Given economic insecurity among this group amid crushing student debt burdens, many decided to move home with their parents.

Higher-income workers less economically impacted by the pandemic drove a more than 20% year-over-year increase in home sales in September and October as many people accelerated their plans to move to single family homes with more space to shelter in place comfortably.[2] Outside of these factors, a number of idiosyncratic dynamics unique to the pandemic helped to propel self-storage fundamentals even further. Restaurants and small businesses adapting to social distancing mandates or even temporarily discontinuing operations contributed to absorption — small businesses comprise a substantial share of total self-storage demand. In addition, with rapidly growing e-commerce logistics demand and record low industrial vacancy rates, small tenants are being pushed out of traditional industrial space, and they are increasingly turning to self-storage for their warehousing needs.

Work from home and learn from home required space optimization through decluttering, while remote learning for college students required self-storage to bridge the gap of temporary dislocation. All the while, tens of thousands of millennials left their expensive urban apartments for more affordable opportunities to work remotely with parents or in their new favorite city or destination.

Self-Storage Relative Outlook Improves. While returns for retail, office and many multifamily investments have softened during the pandemic, self-storage values have held steady and many properties registered an uptick in NOI, after a brief pause at the height of the pandemic. This relative strength has caused many investors to take notice. Recent large self-storage trades underscore investor demand for the sector including Blackstone's $1.2 billion acquisition of Simply Self Storage, StorageMart's recapitalization led by investors including Bill Gates and sovereign wealth fund GIC and Public Storage's $528 million acquisition of a 36-property portfolio from Beyond Self Storage. Occupancy among the publicly traded self-storage REITs hit an all-time high during the pandemic while move-in rates surged 15% year-over-year in November 2020, according to company disclosures. Considering the adverse impact that COVID-19 has had on the overall investment outlook, self-storage arguably offers superior performance potential with less risk compared to most core real estate asset classes.

Self-Storage Operating Risks. While self-storage has delivered compelling historic performance, investors making allocations to the sector today should consider risks unique to today's investment landscape and other risks inherent to the asset class. Although historic excess demand has helped drive landlord pricing power and NOI growth, significant new supply in many markets has challenged fundamentals. Since a majority of users live within a short drive of their storage unit, an in-depth understanding of fundamentals within three–to five–mile trade areas surrounding a site is necessary to help identify the level of potential supply risk. Typically, facilities with seasoned rent rolls featuring higher percentages of "long-term" tenants are more insulated from the threat of competing supply since these facilities have lower tenant turnover as in-place tenants are less likely to canvass the rental market and find potential savings worth the inconvenience of a move. The threat of new supply is much greater when new facilities are competing directly for new tenants, many of which only require space for a few months, forcing landlords to offer steep discounts and deep concessions for extended periods that typically result in prolonged timeframes to reach stabilization.

Idiosyncratic self-storage operating dynamics are best navigated by operators specializing in the asset class. Since most storage customers begin their search online, a significant on-line presence coupled with search engine optimization expertise is paramount, and operators with larger footprints can capture on-line marketing and branding economies of scale. An experienced operator also can drive revenue optimization through upselling insurance and storage products while truncating lease-up timeframes through skilled unit pricing. Owners entrusting management of their self-storage assets to less experienced operators are likely to face a significant competitive disadvantage.

A Favorable Outlook. With deployment of a COVID-19 vaccine underway, market participants are calibrating how self-storage will be impacted. Although a full reopening of the economy will reduce a portion of recent stepped-up demand, the expected lengthy vaccine distribution period suggests that pandemic-related demand is likely to persist for much of 2021 if not longer, and any potential reductions in tenant demand are likely to occur over time, easing the impact. Furthermore, demand from office employees working from home during COVID-19 could be sticky as many continue the practice post pandemic. National storage utilization has quadrupled from two square feet per capita 20 years ago to eight square feet per capita today. This upward trajectory should continue with more stores located conveniently to in-fill suburban and urban housing and enhanced amenities and services including: expanded store footprints for greater convenience, year round temperature controlled units, improved lighting, heightened security, more attractive aesthetics, 24-hour access, and digital marketing innovations. In the medium to long-term, demographic shifts should provide added momentum for storage, including millennials continuing to enter into the family formation phase of their lives. A majority of storage users live in single-family homes, consequently the demographic-driven shift to single family housing, supported by the booming single-family home for rent market, bodes well for the storage sector.

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[1] Gould, Elise and Kassa, Melat. "Young workers hit hard by the COVID-19 economy." Economic Policy Institute, October 14, 2020, https://www.epi.org/publication/young-workers-covid-recession/
[2] National Association of Realtors.

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