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Self Storage Deal Size Rises As Market Strengthens

By **Kaitlin Ugolik**

Law360, New York (August 21, 2013, 6:18 PM ET) -- The market for self storage facilities is heating up in the U.S. thanks to a perfect storm of increasing consumer confidence, low interest rates and an abundance of big portfolios in need of new owners, experts told Law360 Wednesday.

The self storage market has been on a slow upswing since the 1970s, but has really begun to pick up steam over the past several years as major investors who purchased large portfolios five to seven years ago look to divest them and new investors are attracted by healthy revenue streams.

All of the nation's top four public self storage companies have completed or expect to complete more than $300 million in sales and acquisitions of storage properties this year. While the total will likely be about average for the industry, it's the enormous size of the deals that's really striking, Aaron Swerdlin, executive managing director of Newmark Grubb Knight Frank's self storage group, told Law360 Wednesday.

“What feels different about most of this year is that there are fewer transactions, but the transactions are significantly larger,” he said. “It feels more active because a lot of the deals that are getting done are sometimes five to six times larger than what our average is.”

Each of the four public self storage companies closed or signed on to major deals in the first two quarters of this year, according to brokerage and investment banking company MJ Partners Real Estate Services.

Extra Space Storage Inc. has closed or signed contracts for $375 million in deals so far this year, including the $206 million purchase of All Aboard Mini Storage's 20-facility portfolio in California in an off-market transaction, according to MJ Partners' second-quarter market report, released this week.

Cubesmart reported acquiring 11 properties for a total of $107.4 million so far this year, including nine properties in the second quarter. Sovran Self Storage Inc., which runs the Uncle Bob's Self Storage brand, did not acquire any new stores in the second quarter but has three properties under contract for $27.9 million.

The fourth company — Public Storage — is a real estate investment trust with the largest portfolio of self storage properties in the country. It expects to complete the purchase of 29 facilities in the third quarter for about $374 million in cash, totaling 2.3 million square feet at 21 locations, according to MJ Partners.

Last year, as the economy was beginning to cement its post-recession recovery, the self storage market saw private equity firms set their sights on properties that had previously been the purview almost exclusively of established REITs.

The private equity firms and hedge funds focused primarily on properties that had been foreclosed during the downturn, remaining conservative about what they were willing to buy. So far this year, players big and small, public and private appear to be more confident in the strength of the asset class and the market in general, and are making bigger bets on bigger portfolios.

These big deals can be attributed in part to the improving metrics of the self storage industry itself, which is benefiting from an increasing number of Americans' need to downsize their homes, experts say.

“Two point four million Americans are now considered 'missing households,' either living with parents, seniors living with adult offspring and unrelated people renting rooms,” Trulia Inc. Chief Economist Jed Kolko said in MJ Partners' report. “[This number is] far higher than only the 900,000 in 2008.”

Home ownership is also down in the U.S., with only about 65.1 percent of Americans owning homes in 2010, down from about 69 percent at the 2004 peak, according to the U.S. Census Bureau.

These factors make renting a storage space more attractive. At the same time, so does the paradoxical factor of increased employment, which is giving consumers who had to cut out the storage space cost during the downturn the opportunity to rent one again, according to Swerdlin.

The big four public self storage companies all reported at least 90 percent occupancy in the second quarter, according to MJ Partners.

But the growing amount of storage space deal activity is also a result of a backlog, according to Barry Katz of Arnstein & Lehr LLP.

“There is pent up demand,” he said, noting that a lot of owners were ready to exit their self storage investments in 2010 and 2011, but the market for this particular type of property hadn't quite recovered at that time and valuations were down.

As with most asset classes in the last few years, many were forced to hold on to their investments longer than they had originally planned. Now that the property type is performing closer to its peak and financing is easier, REITs and other investors sitting on five- to seven-year investments have found the exit they've been looking for.

“I think what you may be seeing is what's happening in real estate in general, where money is becoming more readily available [and encouraging deals,” Katz told Law360 Wednesday.

One aspect of the self storage real estate industry that still isn't seeing very much growth, however, is construction.

New development is probably about 10 percent of what it was at the peak, when the industry was building 3,000 to 3,500 new properties a year, according to Swerdlin. In contrast, this year he expects to only see about 500 new self storage properties.

But Eric Stern, leader of Morgan Lewis & Bockius LLP's real estate practice, said he believes the demand for new space is there, and new development deals may not be too far in the future.

“[W]hile permitting and entitlements take time, particularly in in-fill locations, construction is not as complex as in other property types, which means it's faster,” he said.

And the great access to capital that the public companies have, coupled with more favorable terms in borrowing and the ability to third-party manage properties without owning them all make for a prime development opportunity.