INVESTING IN SPACE

EXPLORING THE SELF-STORAGE REAL ESTATE SECTOR

The specialized Real Estate Investment Trusts (REITs) landscape is filled with various opportunities, but one sector gaining traction and capturing investors' attention is the self-storage sector. Self-storage REITs are unique investment vehicles that offer a compelling combination of stable returns, growing market demand, and potential for long-term growth. We will delve into the appeal of investing in self-storage REITs, exploring the operations, market demand drivers, potential risks, and innovations shaping the future of this lucrative asset class, with a focus on markets in the U.S., Europe, Australia, and New Zealand.

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Understanding Self-Storage Operations

Self-storage facilities are commercial properties that provide individuals and businesses with rental space to store their belongings. These spaces come in various sizes, catering to a wide range of storage needs, from storing personal items during relocation or downsizing, to stockpiling business inventory and equipment.

The appeal of self-storage operations lies in their relatively simple business model. Once the facility is set up, the operational costs are relatively fixed, while revenue is generated from rental income. Additionally, operating margins tend to be high (70%+), maintenance capex is low (mid-single digits), post-COVID customer retention rates have lengthened, and rent increases to existing customers are typically in the high-single digit to low-double digit range, resulting in a stable cash flow stream for investors.

Operators strategically position self-storage facilities in areas characterized by higher population density to cater to a larger pool of potential users. These facilities are focused on areas that offer convenient accessibility and proximity for individuals and businesses seeking storage solutions. Ideal locations include downtown cores, residential neighbourhoods, and other regions where space is at a premium and living spaces tend to be more compact.

In the U.S., which is the largest market, the self-storage sector displays a high level of fragmentation, with the top 10 largest operators owning approximately 22% of all self-storage facilities.[1] There are more than 51,000 self-storage facilities across the U.S., constituting a diverse mix of privately and publicly owned companies.[2]

In Australia and New Zealand, self-storage has experienced robust growth in recent years due to a housing shortage and the relocation of city dwellers to regional areas. There are over 2,000 self-storage facilities across Australia and New Zealand, with most centres owned by mom-and-pop operators.3 Industry consolidation has led to the top three self-storage operators, National Storage REIT (NSR), Abacus Storage King, and Kennards Self Storage owning approximately 36% of all self-storage facilities.[3]

Despite robust growth in rental and occupancy rates in recent years, the Australia and New Zealand markets still trail behind the U.S. in terms of space per capita. For instance, Australia has 1.8 square feet ("SF") per capita in self-storage space, in comparison to the U.S., which has 9.4 SF per capita.[4]

On the other hand, the European self-storage market is very concentrated in a few metropolitan areas, such as London, Paris, Frankfurt, Berlin, Amsterdam, and Stockholm, to name a few.Compared to the U.S., the European market is still very young and poorly developed. For instance, in the U.S. there is roughly 9.4 SF of self-storage space per capita, whereas in Europe there is only about 0.2 SF per capita.[5]

Market Demand Drivers and Potential Risks

Several factors contribute to the consistent and growing demand for self-storage units, making it a resilient asset class even during economic downturns:

1. Urbanization and Population Growth: As urban areas continue to expand and attract more residents, living spaces become smaller, leading to a need for extra storage space for possessions that cannot fit within limited living quarters.
2. Changing Lifestyles: Lifestyle demands, including frequent relocations for work or personal reasons, have increased the need for temporary storage solutions.
3. Life Events: Major life events such as marriages, divorces, or downsizing create temporary requirements for storage space.
4. Business Storage: Growing e-commerce and small businesses' expansion necessitate storage spaces for inventory and equipment.

One of the bigger risks to the industry is future supply growth. New supply destroys pricing power for operators. Despite concerns over oncoming supply, local government zoning restrictions and their resistance to new developments (given that such developments do not increase jobs or taxes), make the construction of new self-storage facilities more challenging. In addition, the current higher interest rate environment, along with rising land and hard costs, is reducing the profitability of new developments and effectively lowering the outlook for new development starts. This is expected to lead to a more favourable demand-supply dynamic over the next several years.

Innovations Shaping the Future of Self-Storage

To stay competitive and adapt to changing market dynamics, self-storage operators are embracing technological advancements and innovative solutions. For instance, more and more communities are offering e-rentals where customers can sign leases online without ever having to see the actual storage unit or meet an onsite property manager. Newer developments also include an automated leasing process through a centralized call centre, rather than requiring staff to be on site. Operators are becoming increasingly data driven, as they can collect and process meaningful data from new and existing tenants, which allows operators to make more informed decisions when thinking about the profitability of the business.

Public REIT Market Profile

United States

The U.S. self-storage sector has comfortably outperformed the FTSE EPRA NAREIT Index over the last 20 years. Since January 2001, the annualized return has been 15.1% (USD), compared to 6.7% (USD) for the FTSE EPRA NAREIT.[6]

We estimate that the U.S. self-storage REITs are currently trading at a ~20% discount to their net asset value per share and at an average implied cap rate of over 6.2%.[7]

Currently there are four publicly traded companies based in the U.S. and the total market cap has grown to approximately USD $87 billion:[8]

However, in April 2023, the self-storage industry witnessed a significant consolidation when Extra Space (EXR) and Life Storage (LSI) announced a definitive merger agreement. In this all-stock transaction, EXR acquired LSI, resulting in a combined company with an estimated pro forma equity market capitalization of approximately USD $36 billion and a total enterprise value of around USD $47 billion. This merger will establish the largest self storage operation in the U.S., boasting a portfolio of over 3,500 locations and encompassing more than 260 million SF of self-storage space. The transaction, which was approved in July 2023, highlights the significance of economies of scale to maximizing efficiency and margins.

Australia

The main self-storage players in Australia and New Zealand include National Storage (NSR), Abacus Storage (ASK), and Kennards Self Storage (privately owned), owning 17%, 9%, and 10% of the market, respectively.[3]

The market cap for Australia and New Zealand is AUD $4.4 billion, which is comprised of publicly listed REITs NSR (AUD $3 billion) and ASK (AUD $1.4 billion):[8]

NSR, which started in December 2013, has generated an annualized total return of 14.3% (AUD), compared to the global REIT benchmark, which has delivered an annualized total return of 3.3% (USD) or Asia-Pacific REIT benchmark at 0.5% (USD).[9] We estimate that NSR is currently trading at a 28% discount to NAV.[7]

Europe

In Europe, there are currently three publicly listed companies in the self-storage sector, with a market cap of approximately €7 billion.[8]

Big Yellow operates in the U.K., Shurgard Self Storage ("Shurgard") concentrates its efforts in Western Europe, with some assets in the U.K., while Safestore Holdings ("Safestore") focuses on the U.K., with some assets in Paris and Berlin.

As a sector, the three European self-storage companies listed above have generated a 11.6% (EUR) annualized total return compared to the Global REIT benchmark at 4.6% (USD) and the European REIT benchmark at 2.2% (EUR).[10]

We estimate that the listed European self-storage companies are currently trading at a 33% discount to NAV on average, with an implied cap rate of 6.7%.[7]

The stronger public market valuations for European self-storage REITs compared to other property types in Europe is reflective of the attractive fundamentals and strong demand currently being experienced by owners. Further, supply in Europe is lower compared to the U.S. and Australia / New Zealand, which leads to more resilient occupancy rates.

Conclusion

Investing in self-storage REITs can be an attractive proposition for investors looking to diversify their real estate portfolio and enhance returns. With a robust market demand driven by urbanization, changing lifestyles, and business expansion, coupled with technological innovations and a relatively straightforward business model, self-storage REITs offer the potential for steady cash flow and long-term growth.

Sources:

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6. BBREIT Public Self Storage Index compared to FTSE EPRA NAREIT Index; Data Sourced from Bloomberg, 01/01/2001 to 09/30/2023.
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8. Data sourced from Bloomberg as of 09/30/2023.
9. Data sourced from Bloomberg as of 12/19/2013 - 09/30/2023.
10. Represents European self-storage companies in the FTSE EPRA/NAREIT Global Index according to Hazelview's classification, Sourced from Bloomberg, 03/30/2005 to 09/30/2023.