

Self-Storage Demand Poised to Improve Following Inflation-Induced Tempering

Greater household formation underscores self-storage use. The demand outlook for self-storage continues to rise as easing inflation pressures have allowed household formation to accelerate. After CPI increased nearly 9 percent year-over-year in June of 2022, the pace of household formation slowed by half and apartment absorption turned negative. Both trends have since reversed. Nearly as many households formed in the first half of this year as in all of 2023, while apartment net absorption surged to a 10-quarter high between this April and June. As the creation of a household, particularly in a new city, is a prominent driver of self-storage use, this momentum is promising for the sector. National self-storage vacancy will rise in 2024 by its smallest margin in three years despite stubbornly consistent pressure from new supply. A moderating influence on higher vacancy has also come from the nuanced rent dynamics now taking place in the industry.

Rents holding among in-place renters. After climbing by a combined 13 percent between 2019 and 2021, the average asking rent for a standard 10 foot-by-10 foot unit has decreased 6 percent through June of this year. The rent marketed for a vacant unit does not tell the full picture, however. Utilizing data from the largest self-storage REITs, the overall rent from both in-place and new renters held about flat year-over-year through June after rising a combined 30 percent over the previous three years. As occupied units outnumber vacant spaces ten to one, rising in-place rents more than offset the drop in marketed rates. These discounts instead can serve as loss-leaders for new renters, as part of evolving pricing models taking hold in the sector.

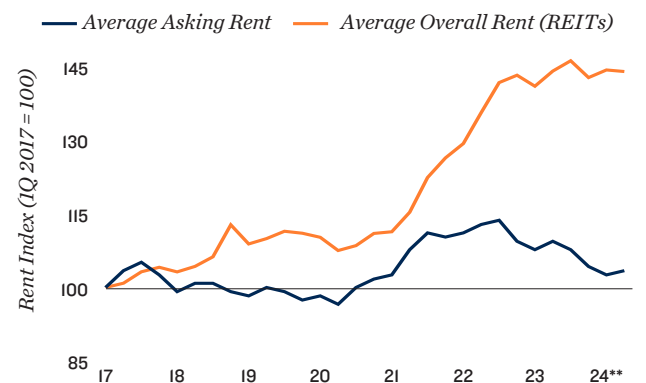
Operations evolving with the investment base. The discrepancy between movements in asking rents and in-place rates is in part a reflection of the growing pool of self-storage investors. Over the past decade the sector observed not only a 40 percent increase in physical inventory, but also a 200 percent jump in the number of yearly trades. As more organizations have entered the sector, business models have become more complex, especially in the nation's larger markets where institutional investors have placed the most focus. The sector's still large share of private investors, meanwhile, continue to be a substantial presence in smaller metros and rural areas. Over the past five years, population growth has accelerated more often in tertiary metros, especially those across the Sun Belt or near large markets. If these dynamics continue, it could draw more attention to smaller markets.

Possible near-term headwinds separate from longer outlook. While the projected 1.17 million households forming this year will exceed the annual average from the relatively stable 2014-2019 period, some headwinds could emerge before December. The national unemployment rate has climbed 60 basis points since the start of the year through July, and while the 4.3 percent measure is still tight by historical standards, the labor market may slow more in the months ahead. Job insecurity could curtail migration in the short-term. These factors pose little impact on longer-run demand dynamics however. Peak income earning years are between 45 and 54, and with the leading age of the Millennial generation at 43, this large cohort is poised to expand their discretionary spending, including on storage units.

Vacancy Rising Amid Stubborn Supply Pressure



Rent Trends Vary by Asking & In-Place

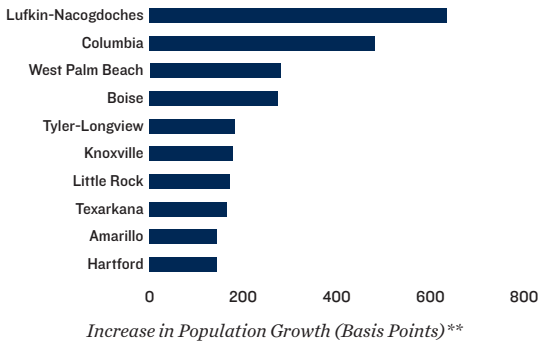


* Forecast ** Through 2Q
Sources: Marcus & Millichap Research Services; Radius+; Yardi Matrix

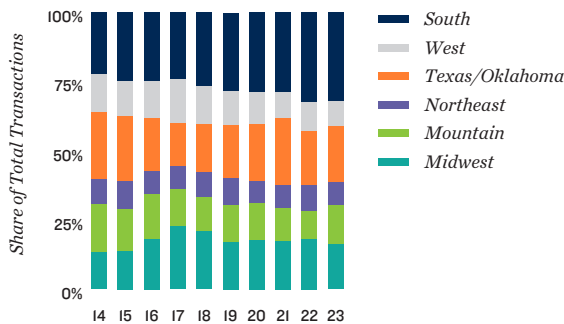
Populations That Grew Faster in 2019-2024 Than 2014-2019



— Top Metros by Population Growth Acceleration —



— South & Mountain Regions Gain Share —



IMPLICATIONS OF SHIFTING MIGRATION PATTERNS

Population growth picking up in small cities and towns. Across the country, most markets observed slower population growth from 2019 to 2024 than from 2014 to 2019. Of the metros where population growth accelerated, most were tertiary cities in the Sun Belt or Rocky Mountain regions. While these zones have long been popular migration destinations, rising living costs are shifting relocating households' focus toward smaller settings in these areas. This dynamic is favorable both for retired households on a fixed income as well as professionals who can leverage remote work. If this trend continues, it poses implications for self-storage space needs.

Investment activity reflecting shift in demographics. While the self-storage sector has been under elevated new supply pressure for the majority of the past decade, more than half of that space has gone to just 25 of the nation's markets. The combination of less development and stronger demographics in smaller cities and towns bodes well for local existing self-storage properties, many of which are owned by private investors. Amid this favorable outlook, long-time holders may seek to capitalize on appreciation in the sector. Sales trends over the past five years reflect the shifts observed in population growth. Since 2019, the share of transaction activity by region has picked up in the Rocky Mountain area as well as the Southeast, though at the expense of the West Coast, Northeast and Midwest. Assets in these smaller Sun Belt settings are likely to appeal the most to other private investors and small groups, as large institutions favor major metros. Since 2020, less than half of all institutional sales activity has taken place outside of major markets.

* Forecast ** Increase in 2019-2024 population growth over 2014-2019 population growth
Sources: Marcus & Millichap Research Services; CoStar Group, Inc.; U.S. Census Bureau

2024 Forecast

EMPLOYMENT

1.3% increase Y-O-Y



- While monthly hiring has slowed over the course of the year, about 2 million jobs will still be created on net. Between 2014 and 2019, an average of 2.4 million positions were added per year.

COMPLETIONS

65 million square feet will be completed



- Although down from the peak 80 million square feet delivered in 2019, nearly as much space will come on-line this year. The 15 most in-development metros will account for 40 percent of the pipeline.

VACANCY

40 basis-point increase Y-O-Y



- During 2006 and 2007, leading up to the previous economic down cycle, vacancy exceeded 14 percent. The national rate will end 2024 at 10.1 percent—a decade high that is nevertheless below that historical mark.

AVERAGE ASKING RENT

2.5% decrease Y-O-Y



- The national average asking rent will fall for a third straight year in 2024 to \$1.19 per square foot. The downshift in market rates may be contributing to vacancy holding below historical points of comparison.

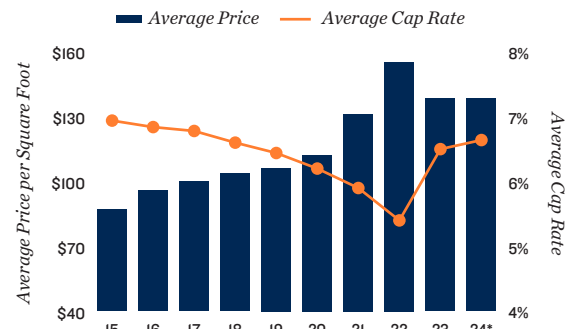
2024 INVESTMENT OUTLOOK

Investment activity continues to exceed historical averages. Self-storage transaction activity picked up over 50 percent between the first and second quarters of this year, also surpassing the spring 2023 period by a similarly high margin. This acceleration helped bring the total number of transactions for the 12-month span ending in June to nearly 200 percent above the annual average observed from 2014 to 2019, when the economy was relatively stable. An average sale price that continues to hold below the 2021 peak and an elevated mean cap rate of 6.6 percent suggest more buyers and sellers are coming to terms.

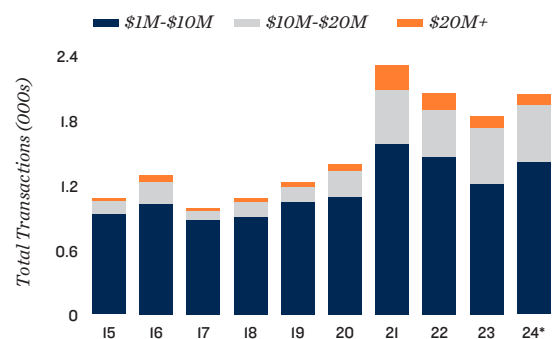
Middle zone of sales pricing sees the most pick up in trading. In contrast to other price tranches, more assets priced between \$10 million and \$20 million changed hands over the four quarter period ending in June than in all of 2021. While primary metros such as Los Angeles and New York recorded some of these trades, most were found in secondary or tertiary markets, including Sacramento, Phoenix, Colorado Springs and Oklahoma City. More than a third of these assets were built since 2018, indicating buyers are finding opportunities among recent builds at various stages of the stabilization process.

REITs explore expansion through partnership. Following the high profile merger between Extra Space and Life Storage, completed July 2023, the large self-storage REITs have expanded their influence outside of acquisitions. This includes adding to the number of third party properties that leverage their management services and exploring joint venture developments. Amid this focus, the share of private investor sales has picked up in recent quarters. Over the course of the year ending in June, three quarters of sales activity took place outside of major metros.

Investment Sales Trends



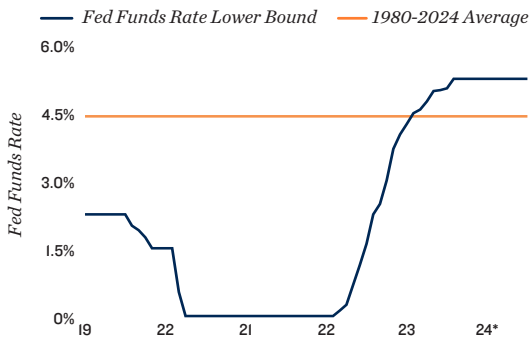
Trading Activity Above Historical Norm



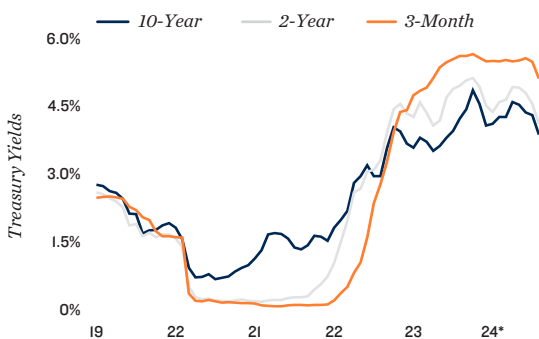
* Trailing 12-months through 2Q

Sources: Marcus & Millichap Research Services; CoStar Group, Inc.

Federal Funds Rate Over Time



Treasury Yields Ease



* Through August 19

Sources: Marcus & Millichap Research Services; Federal Reserve

Recent and Expected Shifts in Interest Rates Poised to Improve Capital Liquidity

Long-anticipated Fed rate cut likely, with benefits for debt markets.

Awaited since the start of this year, conditions as of mid-August appeared favorable for an interest rate cut from the Federal Open Market Committee at its next meeting in September. The FOMC has held the overnight lending rate flat at a lower bound of 5.25 percent since July 2023, keeping borrowing costs elevated. This pressure, however, appears to have successfully tempered both inflation and the labor market. While upward pricing pressures intensified some between February and April of this year, the subsequent three months of data has been more encouraging. Annual CPI inflation eased to 2.9 percent in July, dropping below the 3.0 percent threshold for the first time since March 2021. During the same month, the U.S. unemployment rate jumped 20 basis points to 4.3 percent. The softer job creation data, in particular, prompted a drop in the 10-year Treasury yield to under 4.0 percent, immediately translating into heightened expectations of a Fed rate cut at their September meeting. Prospects of lower benchmark interest rates bode well for debt markets and the investment sales landscape for self-storage real estate.

Recent financial market shift may clear path for more self-storage lending.

Elevated interest rates, by placing pressure on balance sheet lenders such as banks and credit unions, have constrained financing for self-storage investment sales. Many banks are requiring a 10- to 20-percent down payment on a loan proposal, effectively reducing the loan-to-value ratio for the borrower. CMBS sources are more widely available, with the opportunity to secure new loans on a permanent basis for five- or ten-year terms. The drop in Treasury yields between May and August into the 3.8 percent range has made such financing options more approachable to borrowers. All-in rates fell to the low- to mid-6 percent zone in mid-August, compared to levels above 7 percent a year ago. As Treasury yields are unlikely to drop significantly further without a substantial stock to the economy, borrowers interested in this type of debt may take advantage of these lower rates. While lenders using the Secured Overnight Financing Rate (SOFR) benchmark are offering higher rates, one or more cuts to the federal funds rate would help lower that base level. Overall, capital is available for well-performing properties, but unstabilized assets or new construction proposals face greater scrutiny.

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Sources: Marcus & Millichap Research Services; Bureau of Labor Statistics; CME Group; CoStar Group, Inc.; Federal Reserve; Radius+; Yardi Matrix; U.S. Census Bureau