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Buying and Selling Self-Storage: Tips for Investors and Owners

Presented by

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Marcus & Millichap

Considering a Purchase or Sale?

Sellers

Learn what you can do to maximize the value of your facility.

Buyers

Learn how to find the right deals to maximize your investment opportunity.



What We're Going to Cover

Valuation

- Basics: Income, expenses and NOI
- Profit and loss
- Capitalization rate
- Property valuation
- Cap-rate trends
- Location and market types
- Supply and demand

Market competition

- Rents
- Price vs. cap rates
- Treasury rates:
cap rates vs. treasuries

Tips for sellers

- Maximizing value
- Case study

Tips for buyers

- Finding a deal
- Uncovering missed opportunities
- Case study

Case studies

- Institutional
- Class B
- Small market – family-owned
- Portfolio

Conclusion

- National outlook
- Conclusion

Valuation

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Basics: Income, Expenses, NOI

- **Income:** Rental revenue, late fees, admin fees, tenant insurance, etc.
- **Expenses:** Onsite management, insurance, taxes, advertising, utilities, repairs, etc.
- **Exclude:** Leverage, capital expenditures and non-operating expenses

Income - Expenses = Net Operating Income



Profit and Loss

Income			
Scheduled base rental	\$600,000		\$12.00/SF
Economic vacancy	(\$100,000)	16.7%	
Effective gross rental income	\$500,000	83.3%	\$10.00/SF
Other income	\$10,000		
Truck rental income	\$10,000		
Tenant income	\$25,000		
COGS	(\$25,000)		
Non-operating income	\$ -		
Effective gross income	\$520,000		\$10.40/SF
Expenses			
Taxes	\$50,000		\$1.00/SF
Onsite management	\$50,000		\$1.00/SF
Offsite management	\$31,200		\$0.62/SF
Insurance	\$15,000		\$0.30/SF
Advertising	\$15,000		\$0.30/SF
Repairs and maintenance	\$15,000		\$0.30/SF
Reserve for capital improve.	\$7,500		\$0.15/SF
Utilities	\$20,000		\$0.40/SF
Administration	\$15,000		\$0.30/SF
Bank charges	\$10,000		\$0.20/SF
Telephone	\$5,000		\$0.10/SF
Professional fees	\$5,000		\$0.10/SF
Other	\$5,000		\$0.10/SF
Total operating expenses	\$243,700	46.9%	\$4.87/SF
Net Operating Income			
Effective gross income	\$520,000		\$10.40/SF
(-) Total operating expenses	\$243,700		\$4.87/SF
(=) Net operating income	\$276,300		\$5.53/SF

$$\begin{aligned}
 & \text{Scheduled Base Rental} \\
 & \quad - \text{Economic Vacancy} \\
 & = \text{Effective Gross Rental Income} \\
 & \quad + \text{Other Income Sources} \\
 & = \text{Effective Gross Income} \\
 & \quad - \text{Total Operating Expenses} \\
 & = \text{Net Operating Income}
 \end{aligned}$$

Note:

- Excludes leverage, capital expenditures and non-operating expenses.
- Values based on a 50,000 net-rentable square-foot facility, assuming a 6% offsite management fee and \$.15 per square foot allocation to reserves.

Capitalization Rate

What is a capitalization rate (cap rate)?

A rate of return on a real estate investment property based on the expected income that the property will generate.

A cap rate is used to estimate the investor's potential return on his or her investment.



Property Valuation

$$\begin{aligned} & \$600,000 \text{ (Scheduled Base Rental)} \\ & - \$100,000 \text{ (Economic Vacancy)} \\ & = \$500,000 \text{ (Effective Gross Rental Income)} \\ \hline & + \$20,000 \text{ (Other Income Sources)} \\ & = \$520,000 \text{ (Effective Gross Income)} \\ \hline & - \$243,700 \text{ (Total Operating Expenses)} \\ & = \mathbf{\$276,300 \text{ (Net Operating Income)}} \end{aligned}$$

$$\frac{\text{Net Operating Income}}{\text{Cap Rate}} = \text{Property Value}$$

$$\frac{\$276,000}{6\%} = \$4,600,000$$



Cap-Rate Trends

	Primary	Secondary	Tertiary	Average
Class A	5-6%	5.5-6.25%	6.5-7.5%	6.1%
Class B	6-7.5%	6.5-7.5%	7.5-8.5%	6.8%
Class C	6.5-8%	7-9%	8-10%	7.8%
Average	6.3%	7.0%	7.8%	6.7%

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



Location and Market Types

Property selection

- Proximity to major highway
- Traffic counts and visibility
- Proximity to major retail areas

Demographic requirements (3-mile radius)

- Population of over 50,000
- Median household income over \$50,000

Market-type determination

- Primary, secondary and tertiary

Supply and demand

- Less than 8 rentable square feet per person in the subject area (national average = 8.32)

Sources: ESRI, Hoovers, NGKF, MiniCo and U.S. Census Bureau



Supply and Demand

Primary markets – often undersupplied

- High barriers to entry limit new competition

Secondary and tertiary markets – often oversupplied

- Less restrictions makes access to market easier
- Increased competition reduces rental rates and occupancies
- Increased competition increases rental rate volatility

Oversupplied markets – increased risk

- Investors seek a risk premium and demand higher returns
- Demand for higher returns drives increased cap rates



Market Competition

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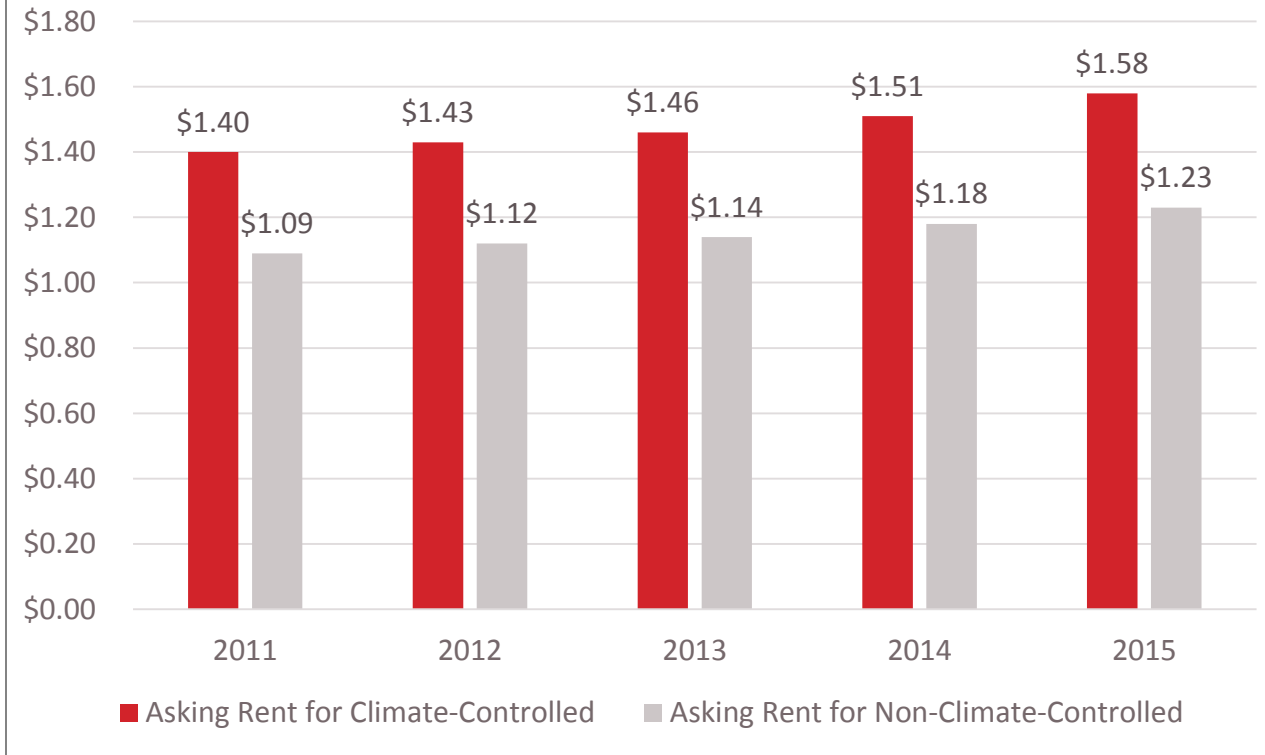
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Rents

National Self-Storage Rent Trends



Annual Rents By Market

Top Five Markets
\$20-30/SF

Primary Markets
\$16 -20/SF

Secondary Markets
\$10-15/SF

*Higher Rents Mean
Higher \$ Per SF*

Notes:

Prices are per square foot.

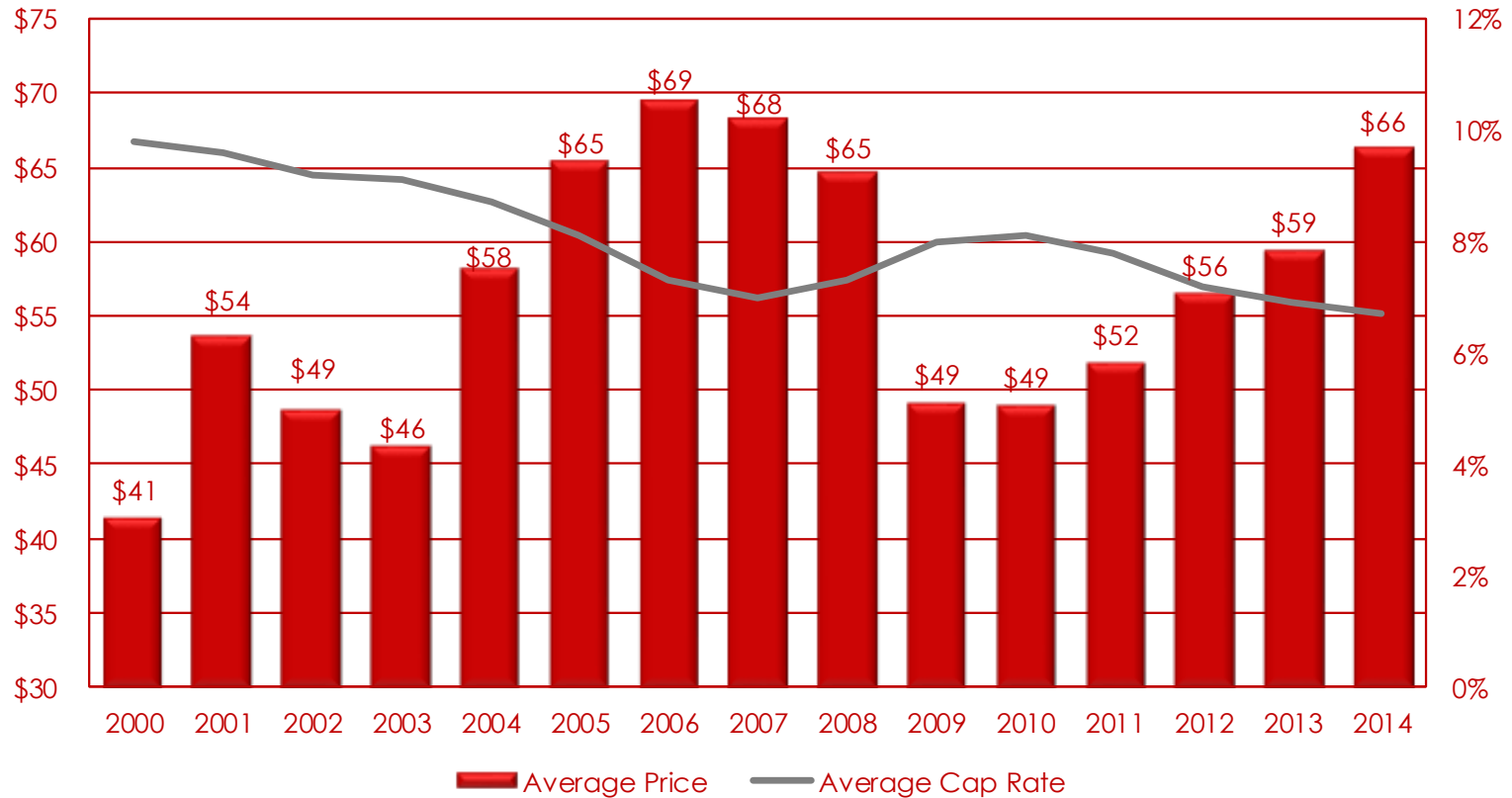
Rents are based on a 10x10 unit.

Sources: Marcus & Millichap Research Services, Reis Services LLC



Price vs. Cap Rates

National Self-Storage Average Price vs. Cap Rates



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

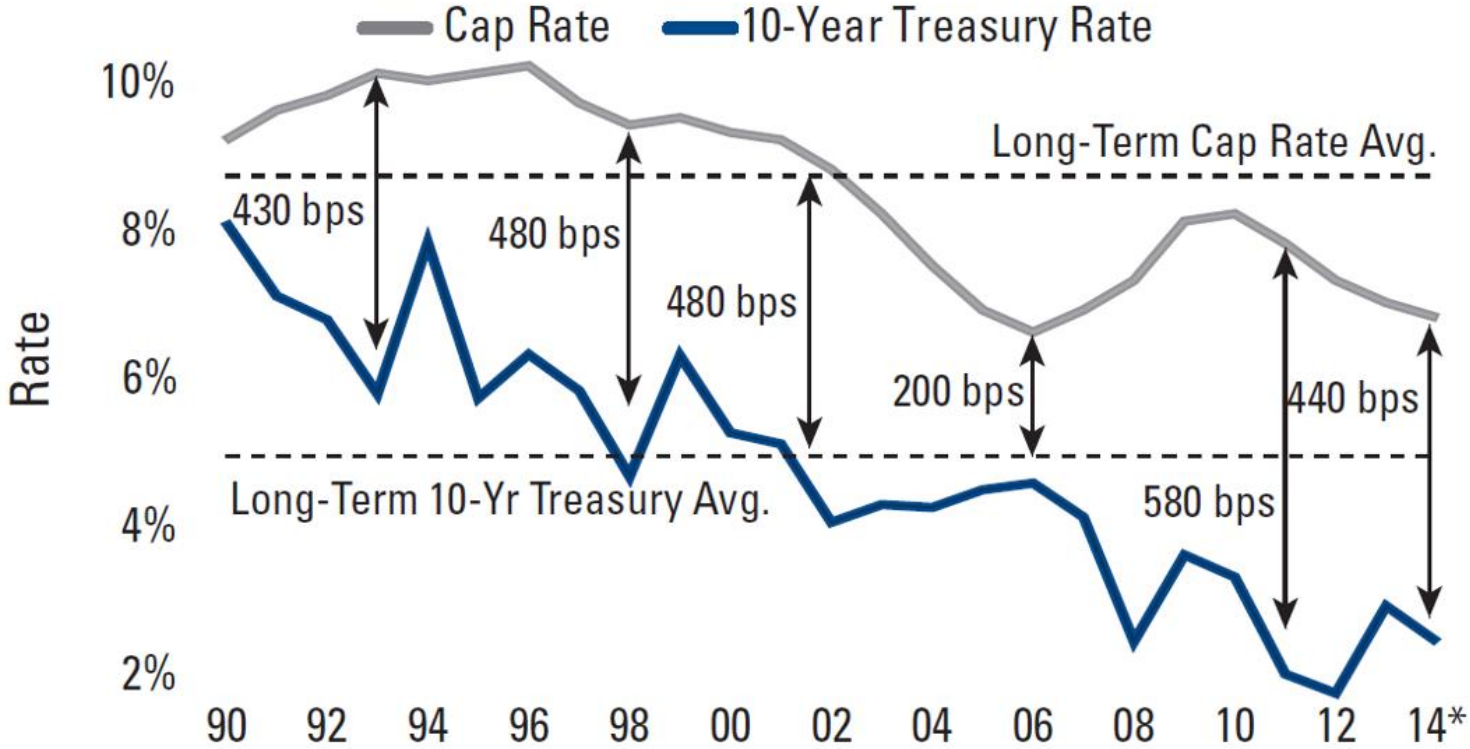
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Treasury Rates: Cap Rates vs. Treasuries



*Through August

Sources: Marcus & Millichap Research Services, CoStar Group, Inc., Real Capital Analytics, Federal Reserve Board


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Tips for Sellers

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Maximizing Value

- **Income maximization:** Rental growth, improved occupancies and adding other forms of revenue (e.g., box sales, truck rentals, tenant insurance)
- **Elimination of deferred maintenance:** Add curb appeal.
- **P&Ls:** Accuracy and timeliness is a must.
- **Competition:** Keep an ever-vigilant eye on sale and rent comparables.
- **Broker selection:** Find a broker with a large portfolio of buyers willing to provide a consistent marketing plan for your property.



Case Study

Subject Property - Highlights

Gross building SF	Unknown
Net rentable SF	110,557
Number of units	1,030
Year built	1979
Physical occupancy	57%
Economic occupancy	37%
Lot size	5.5 acres
Traffic counts	140,600 per day
Population	516,683 in 5 mi.
Median household income	\$55,818 in 5 mi.

Property Valuation

Effective gross income	\$512,203
Expenses	\$423,934
Net operating income	\$88,269
Cap rate	1.58%
Sale price	\$5,600,000
Price per SF	\$50.65



- Initial underwriting = \$45 million (2012)
- Property sale = \$91 million (Spring 2014)
- Assisted seller with income maximization (i.e., improved operational metrics, expense reduction, increased curb appeal)
- Drove competition from qualified buyers

Tips for Buyers

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Finding a Deal

Broker listings vs. off-market deals

Advantages of brokered listings:

- Motivated sellers
- Industry underwriting

Off-market deals:

- Harder to find
- Not always willing to sell or agree to terms
- Searching on LoopNet and other websites
- Unsolicited offers
- Not always highest price or best terms



Uncovering Missed Opportunities

- **Upside potential:** Look at economic occupancy and examine expenses (i.e., room for cuts).
- **Under market rents:** Complete rent surveys in prospective areas.
- **Poor management:** Review operating statistics for underperformance.
- **Market selection:** Complete demographic analysis (e.g., populations, median incomes and traffic counts).

Proper due diligence is a must!



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- Buyer: “Bring a real number, but I can’t list.”
- Proposed value at \$6.6 million, but seller only needed \$5.6 million
- Projected value of \$11 million in two years

Case Studies

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Institutional

Subject Property - Highlights

Gross building SF	88,610
Net rentable SF	71,657
Number of units	643
Year built	2003
Physical occupancy	92%
Economic occupancy	79%
Lot size	4.56 acres
Traffic counts	38,000 per day
Population	140,728 in 5 mi.
Median household income	\$62,264 in 5 mi.

Property Valuation

Effective gross income	\$997,406
Expenses	\$452,112
Net operating income	\$545,294
Cap rate	4.78%
Sale price	\$11,400,000
Price per SF	\$159.09



Class B

Subject Property - Highlights

Gross building SF	Unknown
Net rentable SF	55,168
Number of units	485
Year built	1991 / 1996
Physical occupancy	89%
Economic occupancy	82%
Lot size	4.85 acres
Traffic counts	22,500 per day
Population	32,816 in 5 mi.
Median household income	\$49,036 in 5 mi.

Property Valuation

Effective gross income	\$401,788
Expenses	\$204,268
Net operating income	\$197,500
Cap rate	6.58%
Sale price	\$3,000,000
Price per SF	\$54.38



Small Market – Family-Owned

Subject Property - Highlights

Gross building SF	Unknown
Net rentable SF	31,190
Number of units	330
Year built	1990
Physical occupancy	82%
Economic occupancy	56%
Lot size	2.05 acres
Traffic counts	26,000 per day
Population	71,273 in 5 mi.
Median household income	\$48,216 in 5 mi.
Financial Summary	
Effective gross income	\$154,271
Expenses	\$68,052
Net operating income	\$86,219
Cap rate	8.21%
Sale price	\$1,050,000
Price per SF	\$33.66



Portfolio

Subject Property - Highlights

Gross building SF	Unknown
Net rentable SF	390,154
Number of units	3,147
Year built	1973 / 2009
Physical occupancy	86%
Economic occupancy	81%
Lot size	4.85 acres
Traffic counts	Nashville MSA
Population	Nashville MSA
Median household income	Nashville MSA

Property Valuation

Effective gross income	\$3,017,151
Expenses	\$1,019,347
Net operating income	\$1,997,804
Cap rate	5.95%
Sale price	\$33,600,000
Price per SF	\$86.12



Conclusion

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National Outlook

- **Revenue growth:** Has been considerable, with rent growth in focus given the all time highs in occupancy.
- **Construction:** Building remains well below pre-recession levels, but is gaining momentum with private equity switching focus from acquisition to development.
- **Vacancy rates:** Limited supply growth and increasing demand continue to push down rates.
- **Transactions:** Velocity continues to increase, with competition for deals strengthening.
- **Expense control:** Will continue to provide meaningful benefits.
- **Inflation:** Minimal inflationary expectations should keep interest-rate increases at bay.
- **Interest rates:** Minimal upward pressure for the foreseeable future.



Conclusion

Sellers

We're currently in a seller's market, but without maximizing the value of your facility and developing a comprehensive marketing plan, you're leaving money on the table.

Buyers

Just because we're in a seller's market doesn't mean diamonds in the rough aren't available. By completing proper due diligence, you can still find properties with upside potential.



Contact the Presenter



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