

One of the most common questions asked today is, "Where are self-storage cap rates headed?" As such, we decided to ask that question to industry professionals for this first ViewPoint column.

— Poppy Behrens



Neal Gussis • Beacon Realty Capital

I predict that cap rates in 2007 will move up slightly—perhaps .25 percent from the levels seen at the close of 2006. This reflects several market factors: investors' concerns today of the possibility of higher long-term interest rates, given that the treasury yield is heavily driven by foreign investment, and the uncertainty of whether that demand will shift will impact cap rates; the relative returns for alternative liquid investment vehicles has risen; the housing market has settled; and in certain markets, the actual performance of self-storage properties.

Cap rates should remain strong given that real estate, in particular self-storage, is looked upon as a stable investment with limited downside risk compared with the volatility of some Wall Street investment vehicles.



Chico LeClaire • Marcus & Millichap

The rise in interest rates and the consolidation of REITs within the industry in 2006 will impact the capitalization rates in 2007. Historically, interest rates are still very low and investors are still taking advantage of current financing terms. While the number of lenders has increased, they have become more competitive in the underwriting of self-storage, their financing terms have come more inline with traditional commercial rates, and the spreads have narrowed over the past several years. As interest rates remain constant, cap rates should stabilize.

Another factor in the rise of capitalization rates is the lack of activity from the self-storage Real Estate Investment Trusts (REITs). Consolidation among these industry giants has helped cause a slowing of acquisition activity as the number of REITs competing for investments has decreased with the loss of Storage USA and Shurgard.



Chris Sonne • Cushman & Wakefield Self Storage Industry Group

Self-storage cap rates have plummeted over the past four years. In 2002, the average national cap rate was 9.52 percent. By 2006, the average national cap rate had declined over 225 basis points to an average of 7.26 percent.

This decline demonstrates the high interest in the self-storage asset class over the past five years; however, while cap rates have been declining, interest rates have been increasing. This has compressed equity returns to self-storage. Consequently, self-storage cap rates will be much more sensitive to interest rate changes.

In the near term, there is wide uncertainty about interest rates and the Fed policy. If interest rates rise, I forecast that cap rates will rise. If interest rates remain level, cap rates will follow.



**David Levenfeld
The River Group, Inc.**

The single major disruption in the long-term downward trend in self-storage cap rates was triggered by the medium and long-term interest rate increases of the past year. Now that interest rates have settled back down, cap rates appear poised to remain relatively flat at the historic low levels of the last 12 to 18 months.

Where the real action will be in negotiation over the extent to which buyers are disciplined enough to apply conservative income assumptions and realistic operating expense assumptions to their proformas. Dramatic increases in insurance premiums and an unstable real estate tax environment in many jurisdictions are of particular concern, as both cause significant erosion in the projected value of assets. Sellers may be slow in coming to terms with these new realities; this is likely to create an ongoing value disconnect in the market.



**Ray Wilson
Self Storage
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Self-storage is starting to see more rational investment behavior compared to the frenzied pace of the last few years. Hence, the shift from a seller's market to a buyer's market continues. This means self-storage cap rates, like all other property types, are moving upwards. The exception is with Class A facilities; few of them are on the market compared with the abundance of capital looking to invest in this asset class. For Class B and C facilities, the availability and cost of acquisition capital has increased; the 1031 buyers, high-net-worth individual investors', and REITs that were amassing portfolios in order to go public, have all gone away; and, more B and C facilities becoming available as owners who waited to sell are now implementing their exit strategy. ■