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THE BLEDSOE SELF STORAGE GROUP OF MARCUS & MILLICHAP

I WANT A REAL AND HONEST PROPERTY VALUATION... WHO CAN I TRUST?

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WHERE TO START

Self-Storage facilities come in all shapes and sizes. Perhaps your property has been handed down through your family, or maybe you purchased a value add facility, and fixed it up. Alternatively, perhaps you built your facility from the ground up and have the newest and most state-of-the-art property within a 5 mile radius. It's important to keep track of the commercial real estate market and know where the value of your self-storage property stands within the ever-changing tides of macro & micro trends. This begs the burning question: I want a real and honest value of my self storage facility, but who do I trust?

When searching for an answer to this question, it's imperative to understand a few important factors in determining the value of the property. While there can be many factors involved, the major ones are Capitalization Rates, Internal Rate of Return, the market in which the property is located, and industry/ economic trends on both a local and national level. Let's dive in, shall we?



CAPITILIZATION RATES

THE EQUATION

Capitalization rates (cap rates), are one of the most common and recognized metrics of valuing properties. The equation is simple. Take the net operating income (before debt service) divided by the sale price. For example, a property that has a net operating income of \$100,000 and sells for \$1,000,000, would have a 10% capitalization rate.

As you can see in the graph to the right, the lower the cap rate, the higher the price. Due to interest rates lowering, and the sector becoming more popular, we have seen cap rates compress in recent years, causing properties to skyrocket in value.

Many investors have a capitalization rate in mind, regarding what they'll consider due to recent comparisons in the market. This means some investors may not consider anything lower. While that may be an investment strategy for some, there are other factors that may cause a property with a lower cap rate to still be of considerable value to a buyer. We'll go into further detail in the following sections.



Graph Source: Marcus & Millichap Research Services- September 2022 National Self-Storage Report

INTERNAL RATE OF RETURN

Internal Rate of Return (IRR) is used in evaluating the estimated return a project will provide. According to Property Metrics, “simply stated, the internal rate of return (IRR) for an investment is the percentage rate earned on each dollar invested for each period it is invested.” Many companies look at a 5 year IRR to decide if a property fits their mold. Deciding what IRR is acceptable, depends on the deal you're underwriting. Most investors will accept a 15-20% IRR on a 5 to 10 year basis. However, development projects may not be agreeable to buyers unless an IRR of 25%+ can be achieved. Development projects require higher risk tolerance, which in turn means higher return requirements.

THE MARKET

The market in which a facility is located has a major impact on the price point in which it is valued. Major factors within the market include the population within a 3 and 5 mile radius, the median household income, rental rates of competitors, market saturation, and the expansion opportunity of a facility. Each of these has variables within themselves that can be slightly adjusted and still meet the requirements for an investor to be interested in a facility and find value.

For example, many investment groups may want to see a market that has 50,000+ people in 3 miles with a \$50,000+ median household income.



On paper, this might be great, but if the market is showing an over saturation, then a smaller facility with less desirable demographics may be a better option if there is limited competition, plus room for expansion. Having an expert value your facility, that also understands the market and needs on a micro scale is extremely valuable in pinpointing an accurate number.

INDUSTRY & ECONOMIC TRENDS

Similarly to the above, trends on a macro and micro scale are essential in order to understand a property's worth and future performance. Factors on a macro scale may include inflation, rate hikes/decreases, mass relocations, and national job numbers. A micro trend may include criteria such as vacancy within the market, major employers coming or leaving the area, and construction activity within that market (both residential & commercial).

All of these items can impact a facility's rates, vacancy, and future outlook. For example, according to the 3rd Quarter National Self-Storage Report by Marcus & Millichap, "More than half of the millennial generation is now over the age of 30, a milestone association with growing households. This is spurring relocation activity as members of this cohort pursue larger residences in metros with comparatively lower costs of living."

Vacancy Historically Low Amid Steady Supply



Graph Source: Marcus & Millichap Research Services- September 2022 National Self-Storage Report

With this relocation trend, and architectural trends of open concept housing, the national average of Square Foot per Capita has risen to roughly 12 Square Feet of Drive-up storage and 4 Square Feet of Climate Controlled Storage. This is supporting future growth and expansion opportunities, while keeping vacancy low.

SUM IT UP

With all these factors in mind, it's essential to get a real and honest valuation. Whether it's your sole property or a portfolio of facilities, it's important to receive a valuation as frequently as a yearly basis. Below are a list of important factors and questions to ask:

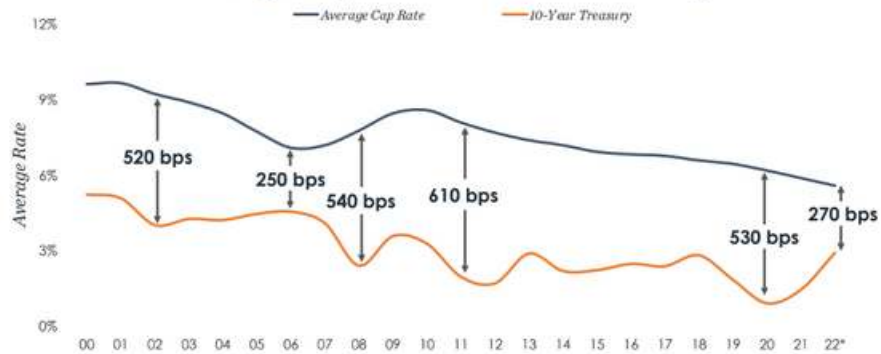
- Do your due diligence in finding a brokerage team that seeks to provide objective & fair valuations
- Don't be afraid to ask how they arrived at their number
- Ask about capitalization rates in the market
- Inquire how they arrived at a IRR investors want to see
- Seek clarification on the local market and economic/industry trends impacting your valuation

Contact the Bledsoe Self Storage Group today to receive a free and honest valuation of your facility.

Sources:

1. <https://propertymetrics.com/blog/what-is-irr/>
2. Marcus & Millichap Research Services- September 2022 National Self-Storage Report
3. Marcus & Millichap Research Services- June 2022 Self-Storage Research Brief

U.S. Self-Storage Cap Rate Trends
Average Cap Rate vs. 10-Year Treasury



Graph Source: Marcus & Millichap Research Services, Costar Group Inc., Real Capital Analytics, Federal Reserve