Investment in Self Storage - Advice Paper

Introduction

The growth of the self storage industry in the UK over the last 10 years has seen the development of a number of methods for investors to become involved in the industry. There are publically listed Self Storage companies, as well as property trusts associated with the industry. A number of Private Equity funds have also made direct investments into owning self storage assets, with management provided by partners or some of the established operators such as Safestore, Big Yellow, Lok’N Store & Storage King.

In a number of these cases, investors have looked for background information and comfort in their decisions by looking at publicly available data, such as the presentations from the quoted Self Storage Companies and information provided by the SSA UK and in particular, its Annual Survey, completed in association with Deloitte Real Estate.

The SSA UK has developed this paper as an overview of some of the risks associated with investing in self storage and areas that potential investors should consider before committing to the industry, as part of their background due diligence on the sector. The SSA UK does not endorse or condone one sort of investment model over another for the self storage industry, but has a view that investors should be as fully informed as possible in advance of their decisions.

More recently there have also been securitised self storage schemes, where individuals can purchase an individual self storage unit that is part of a larger self storage business. This kind of investment scheme has
also been used in Australia in the past, with very limited success in terms of ongoing viability and a poor record of returns to investors.

**Background on the industry**

The typical self storage investment model usually involves an operator securing the freehold or leasehold of a property, then developing and finally opening and operating a storage centre. Storage facilities vary in size and can range from a handful of units to over 1,000 units in some of the largest stores. The facility would have a range of different unit sizes available for the numerous customer needs. Both business and domestic customers use self storage in the UK. Demand for different unit sizes depends upon the intended use of the unit and on the local demographics of the area.

Facilities can vary in size from the smallest of less than 5,000 sq ft (usually where an operator is also managing other business services in the building) up to large stores of 200,000 sq ft or more. The average size of a purpose built UK facility (according to the 2013 SSA UK Survey) is 46,700 sq ft. But facility sizes vary according to their catchment and one of the most important considerations for any new investor is to ensure the facility size being built is suitable to the local catchment the store will serve. A large store in a small catchment will always struggle to deliver occupancy and rental performance.

The self storage industry can be very competitive. The number and quality of competing operators in a market area will have a huge impact on the rents and occupancy of a facility. The main barrier to entry is the capital costs in acquiring the real estate and developing the store. While this is significant it has not prevented self storage becoming oversupplied in some areas.

Freehold investment of property has traditionally been the most common investment option for self storage operators, although leasehold options are also used when the right lease conditions can be obtained. Normally leases with fixed terms of 15 years or more are required to enable the self storage business to recoup the original investment in fit out and business development.
Fundamentals of Self Storage Investment Risk

1. Occupancy Risk - Self storage has significant exposure to vacancy. This is caused by the maturity and size of the facility, local competition and supply, as well as local economic factors. The annual statistical study undertaken by the SSA UK reveals that average occupancy across the UK was 68% in 2013 and has dropped by a few percentage points over the last couple of years. That means that almost 1 out of every 3 units is vacant at present.

Occupancy levels in Self Storage are impacted by a range of factors. Historically the level of property transactions has been a major influence, if more people are moving then demand for storage has increased. The market is also influenced by general economic conditions and the level of disposable income in the community. Local factors such as housing density and sizing will also influence demand for the product.

The lease-up of a newly built storage centre can take several years depending upon how large the centre is. It is fairly typical to take well over 3 years to rent up a 35-40,000 sq ft storage centre. The rate of this rent-up is also determined by the maturity of the store. Typically filling the first 50% of the store can be achieved in the first 18-24 months of trading; the movement from 50% to 65% may take another 18-24 months; and achieving the final growth to 80%+ may take a similar time – or much longer – depending on the economic factors indicated above.

Many stores in the UK are currently in this final occupancy stage following the recent recession and ensuing slow economic recovery. The advantage this industry does have over many other property based investments is that when it reaches maturity a well-managed site has a fairly stable occupancy. The business model is designed around a normal churn of customers in and out and it is extremely unlikely that a large amount of customers would all leave at the same time drastically reducing occupancy levels. There is also only small seasonal variations in occupancy rates and enquiry levels.

While Self Storage does attract some long term customers that hold onto their unit for many years, the majority of customers are typically short -term and need the service as an interim measure only. This means
that most storage units do not remain occupied for long periods, and will suffer transitional periods of vacancy.

The Manager of the facility will have a major impact on the occupancy of the storage centre, and particular storage units or sizes. Their level of training and sales skills are critical in this regard. Any passive investor in the industry should ensure that their investment arrangement has a method of monitoring management performance to agreed objectives and appropriate actions for under (or over) achieving these goals.

Investors in individually owned self storage units should expect vacancy in their unit through the normal turnover of customers and due to any supply issues in the local market.

2. **Brand Risk** – Self storage is essentially a convenience product, and customers will seek to use their closest store to satisfy their storage demands, so long as the services offered are at the right level. However, consumer awareness of the product is still quite low. Typically 70% of customers in a store will not have used self storage before. The low consumer awareness means that knowledge about the service is also quite poor, meaning brand and facility location become very important in drawing customers to a storage operator. The SSA UK report found that 51% of enquiries for a storage operator now come via the website, the second largest source will be seeing the storage building as the customers drive by. So the brand your store uses, the physical location of the store, and the website used to attract customers to the store are all vital considerations when considering an investment in self storage.

3. **Storage Price Risk** - Storage prices are volatile depending upon current competition and market conditions. Rental Guarantees offered to investors should be checked carefully with the local market and competition. **A simple ring around some of the local operators will give an investor a fair idea of the state of the local market.** If market prices are lower than the proposed rent, and incentives and discounts are being offered to win business, then this should be considered in the analysis by investors. If Guarantees of rental income are higher than the existing market rate, then rent decline after the end of the Guarantee is likely. Oversupply of storage space is the most common factor that will push prices downward, generate aggressive opening discounts and cause excessive vacancy.
4. **Secondary Market Risk** - A key part of any investment is the ability to dispose of it profitably at a time of your choice. Listed self storage entities and property trusts have a documented history of share prices and can be traded relatively easily. If you are investing in the physical ownership of an individual storage unit then the secondary market is much less clear. At this time, individual storage units do not have a significant secondary market for the trading of the unit after initial sale from the developer. The most likely re-sale option is to sell back to the management company of the self storage business. However this is reliant on the success of the management company and their ability to finance such purchases. There is no evidence to suggest that individually owned self storage units will experience the same capital growth as other property investments, or even entire self storage facilities.

Having a series of individual owners of self storage rooms also limits the opportunity of redevelopment of that site for alternative use, hence reducing the overall value of the facility in its entirety. It is possible that a secondary market may develop in the future if more of this investment model is used and returns are proven. At this time investors should consider that their ability to realise and exit this type of investment might be difficult and the impact this has on the liquidity of such an investment. This is vastly different to investing in self storage through publically listed companies or property trusts which have clear and easily accessible exit strategies with a documented history of capital gains over time.

There are also the obvious risks to investors if the business does become insolvent. The nature of self storage means that it is not as easy as “shutting up shop” to minimise losses. With peoples goods stored in the facility it can be a time consuming process to locate them and have their goods removed, this requires significant work. Administrators with limited knowledge of the self storage industry are unlikely to manage the business effectively and customers will be unlikely to commit to storage if they feel the business is compromised.

5. **Outgoings and Fees**
The operation of a self storage centre has substantial ongoing expenses. These include advertising, wages, insurance, taxes, property rates, electricity, repairs and maintenance, management fees, training,
stationery, and so on. In assessing the return on investment an investor should make themselves comfortable that all the expenses are disclosed, known and considered.

Self Storage relies on certain ancillary services and capital equipment to run effectively and profitably. Items like security systems, access control systems, traffic barriers and moving equipment are all integral to the operation of a self storage business. There are also common areas such as offices, meeting rooms, driveways and loading bays that need to be maintained as well as utility costs, service costs for equipment such as lifts and general maintenance. When considering any self storage business as an investment these ongoing costs, capital depreciation and replacement costs need to be considered in regards to the business as a whole.

6. Industry Average Return on Investment Estimates - The SSA UK does not provide or offer any estimate of the average Return on Investment. Investors have their own risk and return profiles and should consider all the risks associated with self storage as outlined here and in the local market area. Different locations, different demographics, competitive markets and the varying quality of the storage centres, should all command different risk premiums for investors.

7. Industry Growth - The self storage industry in the UK is still young and in an initial growth stage, although in the last 6 years since the start of the recession this growth has noticeably slowed. Care must be taken when comparing growth in the UK self storage market with that of the USA or Australia, as they are very different markets and the UK is unlikely to reach the supply levels per capita of these markets.

The Australian market, despite being more mature than the UK, still has less than 20% of the penetration of the US market. Any predictions that the level of storage in the UK will reach the levels in Australia, let alone the USA, are completely unfounded and extremely unlikely within the foreseeable future.

The industry in the UK is still in its infancy phase and any figures on the future demand of the industry remain speculative, further evidenced by the decline in growth of the industry since the economic downturn. It is reasonable to expect further growth in the industry and increasing
growth when economic conditions improve, however, only once the industry has reached a level of maturity will more accurate predictions of demand be obtainable. The SSA UK does not endorse any given forecasting method for the growth of the industry for this reason.

8. Location Risk - The success or failure of a self storage centre can be very dependent on its location. Well-located storage properties will be more likely to survive oversupply and economic slowdowns. It is commonly accepted that locations with high exposure and visibility to passing traffic, with good access and few competitors are considered premium. Poorly located properties are likely to be more adversely affected by changes in the market due to increased competition.

Conclusion

The self storage industry in the UK has shown exceptional resilience during the recent recession and tough economic climate. The industry has continued to grow, prices have increased and many operators have also improved profits. However the industry is not without risk and remains heavily influenced by local conditions.

Potential self storage investors are advised to research the industry and the individual investment thoroughly, before investing. This includes close analysis of the local market in which the investment property resides. Incentive schemes such as rent guarantees should also be fully investigated to ensure that they reflect the true returns of the investment. You should research both the financial proposition and also the management team responsible for managing the business and delivering the proposed outcomes.

Investors should make themselves comfortable with all the risks and the local market conditions of supply and demand. These characteristics will impact vacancy levels and pricing in the market. When considering the financial reports of a potential investment always ensure that proper consideration for operating expenses has been made.

As with any significant investment you should seek independent financial advice on the nature of the market in relation to your investment. There are a number of consultants who specialise in the industry and will provide advice based on a selected local market. The
SSA UK would be happy to guide you with any requests you may have in this area.

There are increasing means for investors to become involved in the Self Storage Industry, particularly in a passive sense. The SSA UK views this as a natural progression of an industry growing in stature within the region. We encourage potential investors to consider self storage as an investment opportunity, but urge anyone considering such investments to ensure they have “done their homework” and made their decision based on accurate independent advice and information.

The Self Storage Association UK is releasing this paper for information only and is not endorsing or condoning any investment structure. This is for the benefit of potential investor and advisors and is intended to broaden the understanding, so investors are more fully informed.

**Investors should get their own financial advice and make their own enquiries as to the suitability of the investment for their personal needs and circumstances.**