

Research

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The self-storage market has greatly evolved over the last decade. As education about self-storage and the awareness of its uses has increased, so has the demand for self-storage space. This increase in demand has led to significant supply increases during the last 10 years, on both an absolute and per capita basis, and has increased liquidity in the market. Although supply growth rates have moderated, the industry continues to expand. Along with the size of the market, the industry itself has also evolved. With the advent of REIT ownership, the industry has become more institutionalized. Facilities are more professional, industry-wide knowledge is greater, and analysis of the industry and investments is more sophisticated.

Despite the recent growth, self-storage is still a niche property sector by size. However, self-storage is quite comparable to the apartment property sector. They have similar demand drivers, lease terms and operating leverages. Their cap rates are also comparable because they include expense items, such as leasing commissions and tenant improvements. However, cap rates for self-storage maintain a spread of 150-200 basis points (bps) over apartments. This similarity to apartment makes self-storage different from the other major property sectors and, therefore, offers high diversification benefits to a typical institutional real estate portfolio, which often has a large office/industrial allocation.

As the economy transitions from recovery to expansion, demand for self-storage space should increase. This higher demand, coupled with slowing supply growth, will likely result in moderate rent and income growth in the medium term. This positive outlook for the self-storage industry, attractive cap rates and high diversification benefits make self-storage an attractive consideration for institutional investors.

Industry Profile

Exhibit 1 shows some of self-storage's key features. The estimated size is about 39,000 facilities, totaling 1.46 billion square feet, with an average value per square foot of \$80, resulting in a total market value of about \$120 billion. Thus, self-storage, along with hotels and senior housing, can be considered a significant secondary property class for institutional investment.

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Exhibit 1: Industry Profile

National Data	2004
Total Number of Facilities	38,817
Average Number of Units per Facility	299
Average Facility Net Square Footage	37,590
Total Number of Units	11.60 million
Total Rentable Square Footage	1.459 billion
Average Rentable Square Footage per Person	4.94
Total Market Value	\$120 billion
Value per Square Foot	\$80
MSA Information	
MSA with Most Facilities	Dallas, TX - 1,094
MSA with Most Rentable Square Footage per Person	Austin, TX - 7.97
Market Share	
Largest Self-Storage Company	Public Storage
By Number of Facilities	3.7%
By Rentable Square Footage	6.0%
Market Share of Top-10 Companies	
By Number of Facilities	10.8%
By Rentable Square Footage	16.3%
Market Share of Top-50 Companies	
By Number of Facilities	15.0%
By Rentable Square Footage	23.8%
Average Industry Occupancy Level	84.2%

Sources: 2005 Self-Storage Almanac; Prudential Real Estate Investors

The distribution of US self-storage space varies widely. As shown in **Exhibit 2**, the largest markets by square footage are also generally the largest by population. But a much more useful metric when examining this variation is the square-foot-per-capita ratio, which provides a measure of the supply of self-storage space relative to population. This ratio is about five square feet per capita nationally. As the exhibit shows, this figure varies greatly, with a high of 7.97 square feet in Austin-Round Rock and a low of 1.37 in New York-Northern New Jersey-Long Island.

Regionally, supply relative to population also differs greatly. Of the five regions used when examining the self-storage industry, square feet per capita tends to be highest in the West and South Central regions and lowest in the Northeast. To highlight the regional variation in supply, **Exhibit 3** shows the regional distribution of space by square footage and population. Moreover, by calculating the distribution quotient (the supply share divided by the population share) one can attain a more precise view of the regional variation. The South Central and West regions have higher shares of self-storage space than their population shares, with distribution quotients of 1.47 and 1.19, respectively. The North Central and Northeast regions have relatively underdeveloped self-storage markets, with distribution quotients of 0.83 and 0.54, respectively. The Southeast region's share of self-storage space is almost exactly equal to its population share, with a distribution quotient of 0.99.

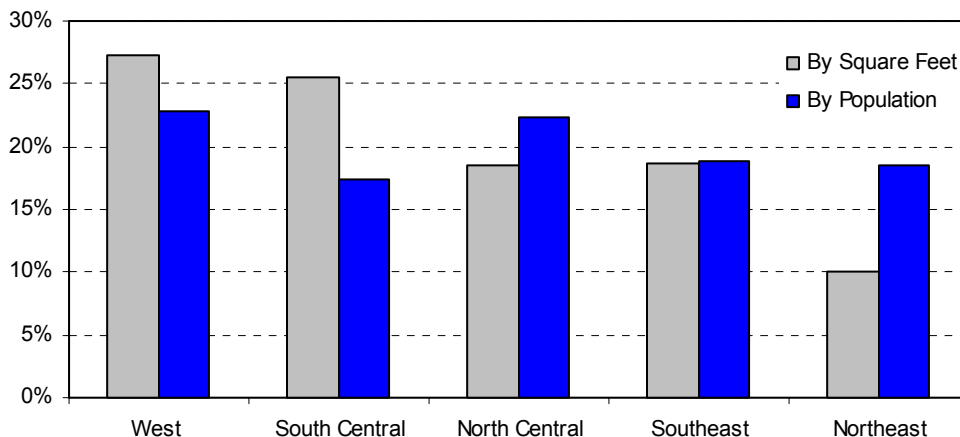
Both the space-per-capita ratio and the distribution quotient highlight the stark distribution differences among MSAs and regions. Although there are no definitive explanations for this variation, the lower relative supply in the Northeast and North Central regions is usually attributed to the prevalence of homes with large attics and basements.

Exhibit 2: Space by MSA

MSA	Facilities	Square Footage	SF/Person
Dallas-Fort Worth-Arlington	1,094	41,123,460	7.11
Houston-Baytown-Sugar Land	1,021	38,379,390	7.33
Los Angeles-Long Beach-Santa Ana	942	35,409,780	2.75
New York-Northern New Jersey-Long Island	686	25,786,740	1.37
Chicago-Naperville-Joliet	622	23,380,980	2.47
Atlanta-Sandy Springs-Marietta	538	20,223,420	4.16
Phoenix-Mesa-Scottsdale	477	17,930,430	4.83
Seattle-Tacoma-Bellevue	466	17,516,940	5.49
Miami-Fort Lauderdale-Miami Beach	466	17,516,940	3.26
Riverside-San Bernardino-Ontario	457	17,178,630	4.70
San Francisco-Oakland-Fremont	457	17,178,630	4.03
Washington-Arlington-Alexandria	399	14,998,410	2.90
San Antonio	356	13,382,040	7.15
Detroit-Warren-Livonia	348	13,081,320	2.89
Philadelphia-Camden-Wilmington	341	12,818,190	2.21
Boston-Cambridge-Quincy	331	12,442,290	2.79
Sacramento-Arden-Arcade-Roseville	328	12,329,520	6.17
Tampa-St. Petersburg-Clearwater	314	11,803,260	4.57
San Diego-Carlsbad-San Marcos	308	11,577,720	3.87
Austin-Round Rock	307	11,540,130	7.97
Denver-Aurora	292	10,976,280	4.56
Las Vegas-Paradise	283	10,637,970	6.33
Kansas City	268	10,074,120	5.20
Portland-Vancouver-Beaverton	261	9,810,990	4.79
Orlando	244	9,171,960	4.89
Nashville-Davidson-Murfreesboro	241	9,059,190	6.44
Cincinnati-Middletown	235	8,833,650	4.26
Charlotte-Gastonia-Concord	232	8,720,880	5.81
Minneapolis-St. Paul-Bloomington	232	8,720,880	2.74
Oklahoma City	226	8,495,340	7.42

Source: 2005 Self-Storage Almanac

Exhibit 3: Regional Distribution



Sources: 2005 Self-Storage Almanac; Prudential Real Estate Investors

In addition, the industry is both concentrated and fragmented, meaning there is significant institutional ownership and many small owners, who often hold just one facility. **Exhibit 4** lists the

20 largest operators by rentable square feet and the number of facilities and units each operates. A few very large operators control more than 30 million square feet each, with Public Storage being the largest, at more than 87 million square feet.

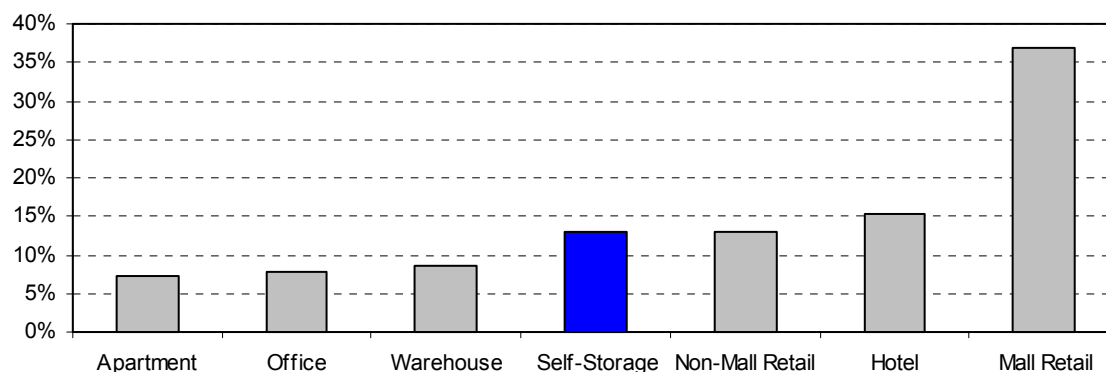
Exhibit 4: Top Operators

Firm	Number of Facilities	Number of Units	Total Net Rentable SF	Facility Average SF
Public Storage	1,442	824,484	87,324,000	60,558
Shurgard Storage Centers	616	283,369	39,000,000	63,312
Storage USA	482	317,900	33,200,000	68,880
U-Haul International	1,044	377,852	32,910,418	31,523
Sovran Self Storage	271	140,000	16,100,000	59,410
U-Store-It	165	93,172	10,154,533	61,543
Extra Space Storage	125	78,400	9,165,000	65,320
Derrel's Mini Storage	43	52,148	7,132,467	165,871
A-American Storage Management Co.	100	64,344	6,600,129	66,001
Private Mini Storage	80	46,000	5,770,000	72,125
National Self Storage Management	93	48,908	5,359,280	57,627
Dahn Corporation	85	50,000	5,200,000	61,176
Storage Inns	100	N/A	5,000,000	50,000
Morningstar Properties, LLC	58	32,000	4,486,000	77,345
Pegasus Group	54	36,300	4,320,000	80,000
Nolan Brothers/Nolan Brothers of Texas	53	33,873	4,115,602	77,653
SecurCare Self Storage	106	35,171	4,095,000	38,632
TNT Self Storage Management	50	63,000	4,012,000	80,240
Metro Storage, LLC	63	33,800	3,900,000	61,905
Platinum Storage Group	40	34,000	3,625,000	90,625
Top 20 as a Percentage of Total	13.1%	22.8%	20.0%	N/A

Source: 2005 Self-Storage Almanac

More important is the share that the top 20 holds as a portion of the total industry. By all three measures, the top-20 operators hold a minority of the industry, controlling only 13% of the facilities, 20% of the square footage and 23% of the units. Also, as **Exhibit 5** shows, the public market ownership share of self-storage is 13%, which is higher than that of the apartment, office and warehouse sectors. Despite public entities and large institutional players controlling a big part of the market, small, local, individual owners still represent the majority.

Exhibit 5: Public Market Ownership Share



Source: Prudential Real Estate Investors

Demand Generation

Self-storage tenants fall into four main categories: residential, commercial, student and military. While institutional investors should know the current composition of demand, understanding the *trend* in demand composition is vital.

The residential segment of demand is by far the largest, constituting 75% of the tenancy. Although this has traditionally been the largest segment, its share has declined in recent years. Because residential likely will remain the biggest demand group, it will always be crucial to self-storage success. The average lease term for residential self-storage is 12.6 months.

The commercial category is the second-largest segment of demand, accounting for 20%. This group has grown in recent years and is likely to form a greater percentage of total tenancy as more small- and medium-sized businesses rely on self-storage, particularly for records retention. Self-storage operators covet this segment because of its timely rent payments and long leases. At an average lease term of 22.9 months, they are the longest leases of any segment. The student segment is small but stable, hovering around 3%. Although it has the shortest lease term, at 4.4 months, (slightly longer than summer vacations) this segment is valuable to the industry because it introduces the next generation to the usefulness of self-storage. The military segment is also small, at 2%. However, this group is important because its average lease length is 12 months. With more US troops now overseas, demand has heightened.

Close analysis of self-storage demand reveals the property sector's similarities to the apartment sector, which is more familiar to institutional investors. Apartments have a demand segmentation similar to self-storage, with a smaller commercial share (known as corporate apartments). Self-storage also has an average lease term quite similar to that of apartments. The weighted average lease term for self-storage is 14.4 months, which is not significantly different from the average 12-month lease for apartments. The largest segment of demand, residential, has a 12.6-month average lease term, which is almost identical to that of apartments. Also, because of the short leases, owners can quickly mark self-storage leases to market, as they can with apartment leases.

Long-term self-storage demand has six key drivers. The first is population growth because the higher the population, the greater the likelihood that someone will need additional storage space. The second is the percentage of renter-occupied housing units because rental units are usually small, with little or no storage space. The third is average household size because the larger the household size, the more goods will be accumulated, which creates a demand for self-storage. The fourth is average household income because a larger income not only creates the ability to buy more, but also provides the money to rent space. The fifth is supply constraints because constraints, such as higher construction costs, lead to higher rents, thus limiting demand for self-storage. The sixth generator is economic growth because it increases people's desires and needs for additional space as new jobs are created. Awareness and acceptance of self-storage as an option for space needs is vitally important, but more as a prerequisite than as a driver of demand.

Because the self-storage demand drivers differ from those of office, industrial and retail, self-storage offers high diversification benefits to institutional real estate portfolios, which typically

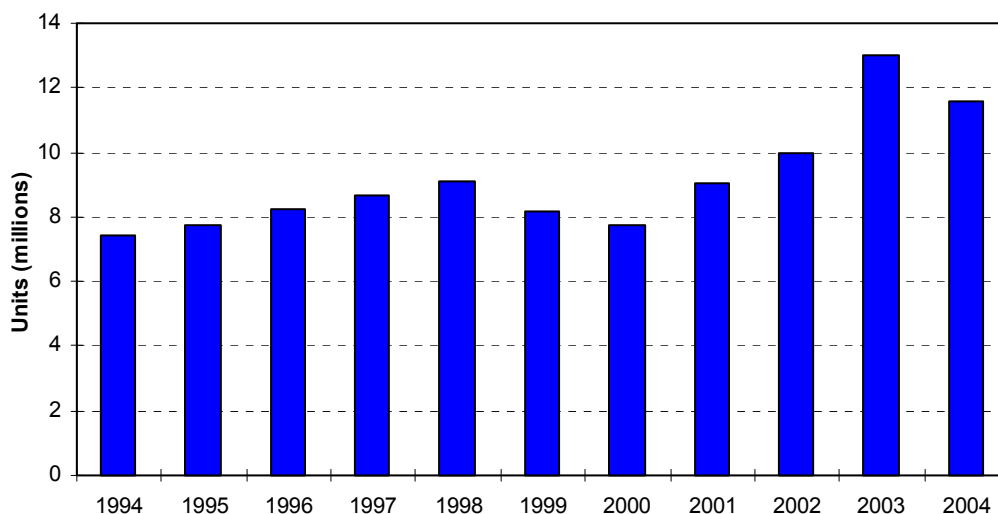
have their largest allocations in office/industrial. As the commercial segment becomes a larger percentage of the tenancy, corporate demand drivers that affect the office and industrial sectors could have a larger impact on demand for self-storage. However, this is likely to be muted because, despite the growth in the commercial segment, the residential segment will still be the majority of the tenancy.

Supply Growth

As measured by the two most useful metrics, units and square feet, supply has risen significantly over the last few years. But supply data is problematic because it is based on survey results and thus is imprecise. Although data collection methodology is improving, anomalies in the data, such as a significant one-year decline in supply, still occur and should be treated skeptically. Therefore, self-storage supply data should be seen in the context of the overall trend.¹

Total supply, as measured by units, was basically flat from 1994 to 2000, as shown in **Exhibit 6**. Although it appeared to be on an upward trend, the number of units during that period peaked in 1998 at 9.1 million. Decreases in 1999 and 2000 brought supply down to 7.8 million units, only a little higher than the 7.5 million units in 1994. However, supply growth rose again in 2001. During that year, 1.3 million units were added. The supply of units peaked in 2003 at 13.0 million before falling to 11.6 million units in 2004. Even with the slight decline, this still equates to a 3.8-million-unit increase since 2000. This is a 49% rise in supply over the last four years, whereas the previous six years had been essentially flat.

Exhibit 6: Total Supply in Units

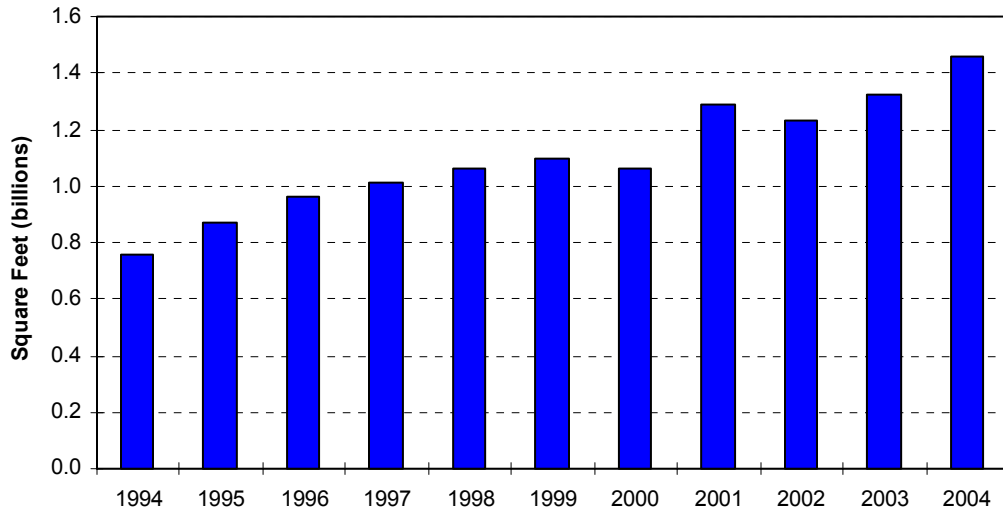


Sources: 1998-1999, 2000, 2001, 2005 Self-Storage Almanac

¹ The data used in the analysis of total supply is from the 1998-1999, 2000, 2001 and 2005 Self-Storage Almanacs. This data is derived from annual surveys sent to a sample of facilities selected from a MiniCo-maintained database. In addition to being based on a sample of data, the yearly response rate is low and varies significantly. For example, for the 1998-1999 survey, the response rate was 16.3%; for the 2005 survey the response rate was 7.5%.

The trend for total supply in square feet is similar but not as stark. As **Exhibit 7** shows, supply in square feet was on an upward trend before 2000, peaking in 1999 at 1.1 billion square feet. But, like supply in units, supply in square feet actually fell slightly in 2000. Since 2000, the trend has been upward again, as 395 million square feet have been added during the last four years. This represents a 37% rise in supply measured in square feet during that time. This addition to supply is 90 million square feet greater than the 305 million square feet added from 1994 to 2000.

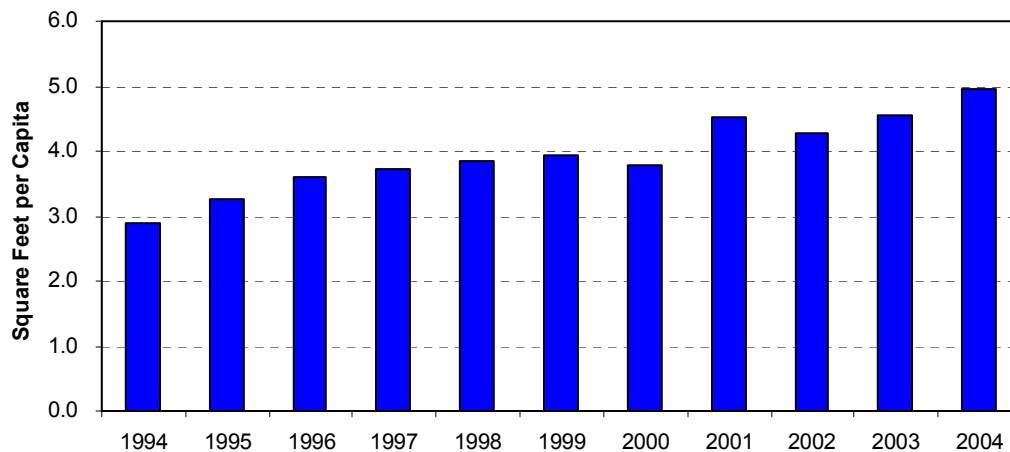
Exhibit 7: Total Supply in Square Feet



Sources: 1998-1999, 2000, 2001, 2005 Self-Storage Almanac

Supply relative to population has also grown in the last 10 years. As shown in **Exhibit 8**, space per capita has been steadily rising from 2.9 square feet per capita in 1994 to 5.0 in 2004. This is due, at least in part, to the growing size of the average rental unit. In 1994, the average unit was about 102 square feet. Today it is about 126 square feet. But supply growth was largely a response to the gradually released pent-up demand as self-storage became more popular with end-users.

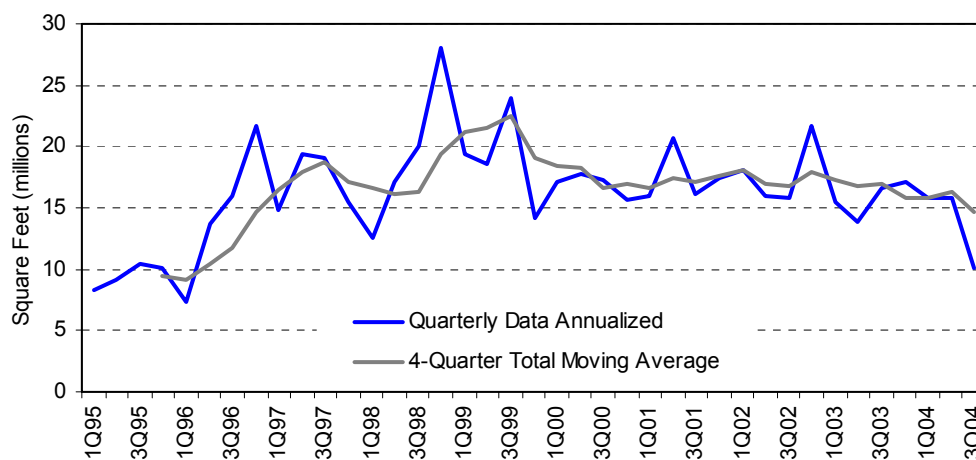
Exhibit 8: Supply Per Capita



Sources: 1998-1999, 2000, 2001, 2005 Self-Storage Almanac; Prudential Real Estate Investors

Self-storage supply has grown faster than the population during the last 10 years. Although some are concerned that supply is expanding too rapidly, this seems unlikely. **Exhibit 9** shows the annualized quarterly self-storage starts data and the four-quarter moving average. Self-storage starts have been declining recently, and starts are currently about 15 million square feet, or 1% of the existing supply, per year. This is essentially in line with a projected annual average population growth rate of 0.8% and an estimated 0.2% self-storage depletion rate. Alternatively stated, in the medium term, population growth alone will absorb incremental supply.

Exhibit 9: Self-Storage Starts

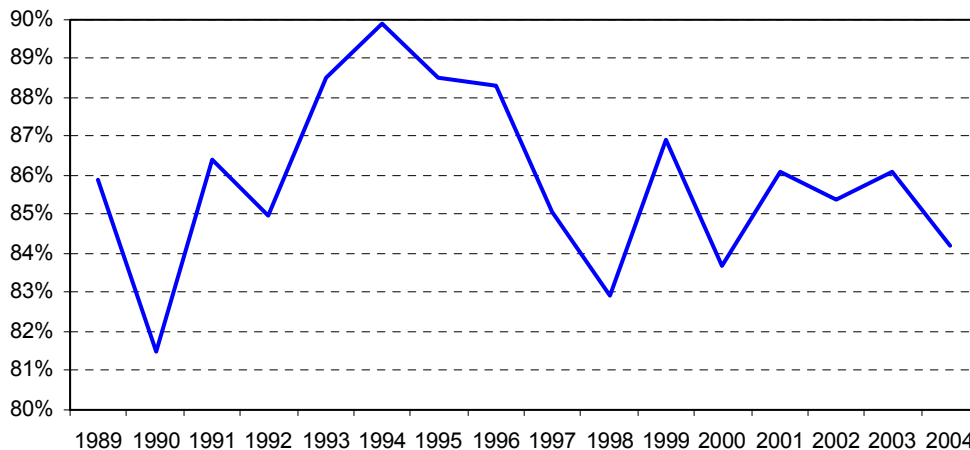


Sources: FW Dodge; Citigroup/Smith Barney

Occupancy and Rent

Despite the explosive growth in supply, occupancy has remained largely unchanged over the last 15 years, as shown in **Exhibit 10**. Occupancy peaked in 1994 at about 90%, but the supply increase during the last 10 years has brought occupancy back in line with its natural rate, which we estimate to be 85% nationally. Over the last 15 years, the mean occupancy rate has been 86%, slightly above the estimated natural rate but essentially in line.

Exhibit 10: Occupancy



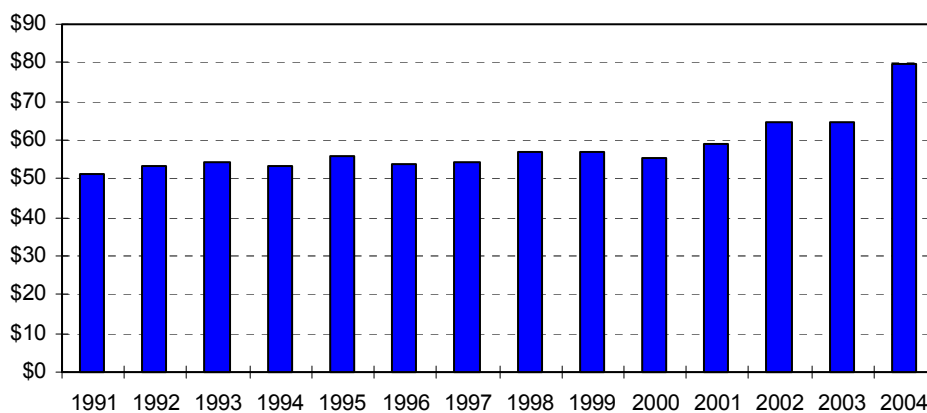
Sources: 1998-1999, 2000, 2001, 2005 Self-Storage Almanac

The occupancy trend highlights how demand for self-storage space has grown over the last 15 years. Despite the supply increase, the virtually unchanged occupancy rate shows that demand has risen. Not only has occupancy kept pace with absolute supply increases, but supply relative to population has also increased. The average unit size has expanded, but this only partly explains how supply per capita has grown, while occupancy has remained largely unchanged. The average unit size grew 23.6% between 1994 and 2004. The square-feet-per-capita ratio rose 72.4% during this time. Thus, the sustained occupancy level also indicates a greater acceptance of self-storage by the residential category and greater use by the commercial segment.

Although it appeared that demand was outpacing supply in the early 1990s as occupancy raced toward 90%, supply increases have brought the market back toward equilibrium. Given that the projected pipeline will likely be about equal to the population growth, the occupancy rate will probably hover around 85% in the medium term. This consistent level of occupancy provides self-storage with stable cash flows, which make it a highly financeable property class.

Unlike the occupancy rate, rental growth has risen since 1991 but has been strong only since 2000. **Exhibit 11** charts the average monthly rent for a 10x10 storage unit. From 1991 through 2000, rental growth was about 7.8%, having risen from \$51.13 per month to \$55.10. But from 2000 through 2004, rental growth was 45%, rising from \$55.10 per month to \$79.87. During this 13-year period, 10x10 rent growth has averaged 3.7% per year. Expanding demand and relatively limited new supply will likely result in moderate rent increases in the medium term.

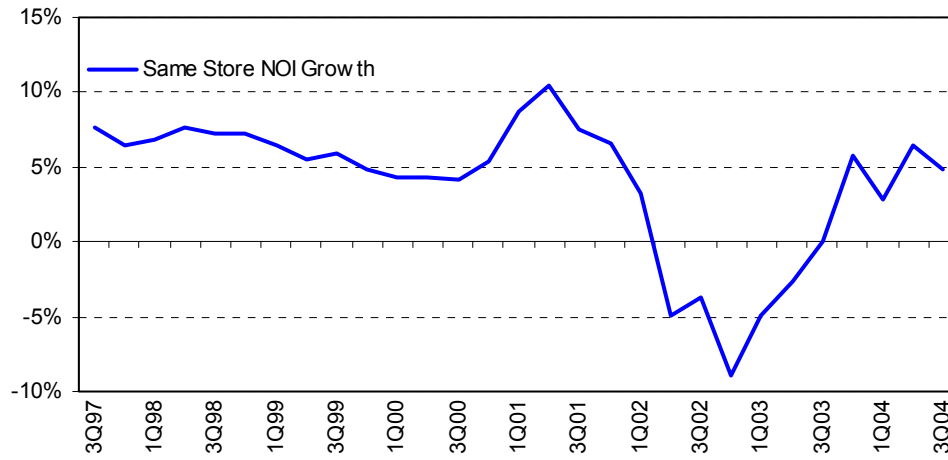
Exhibit 11: 10x10 Foot Storage Unit Monthly Rent



Sources: 1998-1999, 2000, 2001, 2005 Self-Storage Almanac

On the public market side, the cyclical nature of the self-storage market is more evident, as depicted in **Exhibit 12**. This chart clearly shows how sensitive the self-storage market can be to economic downturns and how it suffered during the past recession, largely from reduced employment lowering demand for self-storage space. The exhibit also shows that the self-storage market is in its second year of recovery. Although quarterly NOI growth has averaged about 4.0% over the last seven years, it seems that NOI growth of 3% to 4% is achievable over a complete market cycle. Over the short term, NOI growth could be higher than the mean rate of 4.0% as the market recovers.

Exhibit 12: Self-Storage REIT NOI Growth



Source: Citigroup/Smith Barney

Risk Profile

The outlook for the self-storage market is cautiously optimistic, with a recovery underway, but institutional investors must understand the risk profile of the sector before investing. Self-storage might be unfamiliar to some institutional investors, but its risk characteristics are most similar to the apartment sector, which should help to demystify self-storage.

The first similarity, as mentioned above, is that self-storage and apartment have comparable demand segments, particularly the two largest, residential and corporate. A typical apartment lease is 12 months long, which is virtually identical to the residential segment lease term for self-storage of 12.6 months. This is important because the majority of tenants for both property types are individuals. It is not surprising that these terms are so similar since empirical models show a relationship between rental households and self-storage demand.

Secondly, unlike office, industrial and retail, cap rates for self-storage and apartment include expense items, such as leasing commissions and tenant improvements. Self-storage has a comparable, or even lower, ratio of operating expenses to revenue than apartment, usually in the 35% to 40% range.

However, one key difference exists between apartment and self-storage cap rates. Despite the recent cap rate compression that all property sectors have experienced, self-storage maintains a 150 to 200 bp spread over apartment. This is very important, given that self-storage's underlying risk characteristics are so similar to the apartment sector's risk characteristics. Cap rates for the whole self-storage sector were in the 8.5% to 9.0% range in 2004. Institutional-quality assets, which were sold much less frequently, traded in the 7.0% to 7.5% range.

Also, self-storage has locational attributes that are similar to retail. Because of the largely consumer customer base, both seek high drive-by visibility. Although self-storage is not subject to the co-tenancy issues that can affect retail properties and is less sensitive to adjacent land uses,

convenience is important to their end-users and, thus, both property types tend to locate near residences.

Summary

The US self-storage market has grown to about 1.5 billion square feet, or five square feet per capita, with an estimated market value of \$120 billion. The self-storage industry has matured over the last few years. Relative to other property sectors, it has an above-average public market ownership share and has significant institutional participation. Conversely, small owners and operators still control the majority of the business. As a result, the sector is both highly institutional and highly fragmented.

Long-term demand for self-storage is tied to population growth, household formation, growth of rental households, and acceptance of self-storage as a viable option for space needs. Its growth trend can be interrupted in the short term by the business and employment cycles. A weak job market not only decreases income and employment but also temporarily suppresses voluntary employment turnover, as happened during the most recent recession. As employment transitions from recovery to expansion, demand for self-storage is recovering and strengthening.

Self-storage has a mild but distinct supply cycle. Barriers to entry are relatively low, but supply growth has moderated recently to about 1% of current supply, in line with a 0.8% population growth rate and an estimated depletion rate of 0.2%. Expanding demand and relatively low supply will likely increase market occupancy in the coming years. Rents and income are likely to grow faster than inflation in the medium term.

Self-storage offers excellent diversification benefits in two ways. First, self-storage can be highly diversified by location, tenancy or property, similar to the apartment sector. Second, although its demand drivers resemble those of apartment, its demand patterns are quite different from the office, industrial and retail sectors. Therefore, self-storage offers high diversification benefits to a typical institutional real estate portfolio – the biggest component of which is usually office/industrial.

Self-storage was not immune to cap rate compression over the last three years. But self-storage's spread of 150 to 200 bps over apartments, its most comparable property sector, makes it an attractive option for institutional investors. Although not identical to the apartment sector, self-storage has similar demand segments and drivers, lease terms, and operating leverages. Thus, self-storage can enhance returns and further diversify a typical institutional real estate portfolio.

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