Cap Rate Compression Continues – Newmark Investors Survey Q3 2021

By R. Christian Sonne, CRE, MAI, FRICS - Originally published for MSM -October 28, 2021

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By The self-storage asset class is now generally considered CORE or CORE+ commercial real estate, comparable to office, industrial, retail, and apartments based on robust underwriting criteria in our latest Investor Survey for the sector. Since our last survey six months ago, cap rates have compressed an astonishing 44 basis points, on average, to an average cap rate of 4.93 percent based on the Newmark Self-storage Investor Survey for Q3 2021.

Cap rate compression was most significant for Class-C properties located in secondary and tertiary markets with a decline of 75 basis points over the last six months, as the competition to place capital in the sector continues to heat up. In the public REIT markets, self-storage has continued to soar with YTD Change in stock pricing up 55.7 percent, compared to S&P 500 increases of "just" 20.83 percent over the same time period (as of Oct. 15, 2021). Key performance indicators are shown in the following table:

Self-storage rental rates and occupancy levels are at all-time highs, while cap rates are at all-time lows, resulting in new high benchmarks in single asset and portfolio pricing. Moreover, new construction is limited by supply chain challenges, leading to uncertainty in material pricing and delivery dates. As a result of these risk factors, profit factors on new development have increased. A recent picture off the Port of Long Beach highlights the challenge.

Our Investor Survey for Q3 2021 not only indicates accelerated compression in cap rates and increased profit factors on new construction, it also indicates compressing yield rates and rising terminal cap rates for discounted cash flow (DCF), and DCFs are utilized by 92 percent of investors. This is a fundamental underwriting shift for the sector because it is more analogous to CORE-based properties. So while cap rates are compressing, yield rates (discount rate or Internal Rate of Returns) are compressing factor with lower spreads to cap rates. However, terminal cap rates (at the end of a holding period) are rising at five to 10 bps per year of the holding period. This is to account for future risk. While the modeling does not fundamentally change valuation conclusions, it demonstrates that the market views self-storage and makes investment decisions about self-storage more like CORE properties.

It is also interesting to note that while 10-Year Treasuries continue to rise, self-storage lending rates have compressed slightly. Equity requirements have also declined for single assets but remain above publicly traded REIT dividends for the asset class. While the spread to apartment cap rates narrows for self-storage, the spread between the 10-Year

Treasuries is 334 bps, lower than the 20-year average spread of 3.89 and significantly above spread lows experienced in 2006 of 254 bps. This helps explain market sentiment of the market with the highest optimism score ever surveyed at 8.74 (scale 0 to 10). Market participants also expect cap rates to continue to compress well into 2022 for self-storage.

Due to strong operational and investment performance during the pandemic, new capital continues to store capital in the sector. Low loan losses, outperforming CORE CRE, has led to an abundance of debt facilities at wide availability. The public markets (self-storage REITs) continue to outperform alternative investments.

The self-storage team at Newmark Valuation & Advisory surveyed market participants about a wide variety of data points, including the usual cap rate, yield rate, and growth rates. Survey participants include buyers, brokers, owners (small and large operators including REITs, national, and regional owners), investors, lenders, and REIT analysts. Most interviews were by telephone or electronic conferencing. Survey research interviews referenced in this report occurred primarily in the Q3 2021. Additional information includes trade area size, absorption time, marketing time, profit on costs, optimism index, and other metrics. Over 50 market participants were interviewed, bolstered by anecdotal insights gained from a record number of calls with key market participants. Survey results are summarized and compared to 10 years of data in the Self-storage Time Series – Survey Research chart as follows:

Segmentation by Investment Quality - 3Q 2021										
	Class A	Class B	Class C							
Discount Rate (IRR)										
Range:	6.00% - 7.75%	6.50% - 8.25%	7.00% - 9.50%							
Average:	7.00%	7.75%	8.40%							
Capitalization Rate										
Range:	4.00% - 4.75%	4.50% - 5.25%	5.00% - 6.50%							
Average:	4.56%	5.10%	5.50%							
Terminal Capitalization Rate										
Range:	4.25% - 5.25%	4.75% - 5.75%	5.25% - 7.00%							
Average:	5.00%	5.40%	5.95%							

Source: New mark Self Storage Investor Survey, 3Q 2021

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Page 10-10	Self Storage Time Seres -	Survey Resea	inch										
Page 10-10		30 2021	10 2021	30 2020	30 2019	30 2010	30 2017	30 2016	2015	2014	2013	2012	2011
Margin 140	Tra de Area (Miles)												
Charge 150	Rarge:	1.00 - 5.00	1.00 - \$.00	1.00 - \$.00	1.00 - \$00	1.00-5.00	1.00 - \$.00	1.00 - \$.00	1.00-5.00	1.00 - \$00	1.00 - \$.00	1.00 - 5.00	1.00 - 5.00
Part	årenge:	9.90	9.29	9.25	9.20	9.18	9.14	9.25	220	9.90	9.25	9.22	9.20
Page 1-14	Change:	1.23%	0.91%	1.56%	0.69%	1.27%	4.2%	1.56%	-9.09%	1,54%	0.99%	0.99%	#DIVID
Margin 17	Demand (SF per Penson)												
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Care Standardo No. 1987 - 1987	årenge:	7.7	7.4	7.9	7.5	7.1	6.9	7	7.1	7.1	7.95	7.91	7.5
Page 1,00	Change:	4.05%	1.97%	4.6%	5.69%	2.80%	4.6%	-1.41%	No Change	-9.40%	0.55%	2.26%	#DVG
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August Company Compa	Average:	4.99%	5.97%	5.50%	5.60%	5.66%	5.60%	5.64%	5.78%	290%	6.25%	9.796	7.00%
Page 1	Change:	44	-19	-10	4		4	40	-19	45	-20	-66	790
Marager 92 94 94 95 96 96 96 97 98 98 90 98 98 98 98 98	Absorption Time (Months)												
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Martenge 1-6 Mart	Average:	92	94	99	2	90	29	27	28	29	90	99	26
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Marager 43	Marketing Time (Months)												
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Party (pro Case Coty) Range	årange:	49	4.0	9.0	4.4	4.2	9.7	4.0	9.5	20	9.0	9.0	4.0
Page 201-202 591-4291 591-4291 591-201 591-2	Change:	0.9	-2.0	1.6	0.2	0.5	-0.9	0.5	0.5	No Charge	No Change	4.0	4.0
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Page 1.00 450-1000 450-1000 500-800	Change:	20.00%	-9.65%	4.00%	4.17%	4.95%	4.0%	19.09%	No Change	200%	14.29%	19,67%	EDVID
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Holsing Parloc: 10 Years 10 Ye	Discounted Cash Flow												
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Austige: \$15% \$20% \$20% \$20% \$20% \$20% \$20% \$20% \$20	Expense Growth Rate												
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Terminal Cap Rass Range:	årange:	915%	9.00%	9.09%	9.10%	9.00%	9.03%	9.01%	2.90%	200%	9.00%	9.25%	9.00%
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Owenge: \$50% \$60% \$.60% \$.60% \$.60% \$.60% \$.60% \$.60% \$.60% \$.60% \$.60% \$.60% \$.00% \$.7.00% 7.50% \$7	Terminal Cap Rate												
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Speadro Cap Para (Sask Poins 40 09 05 05 05 04 09 00 07 05 05 05 00	årange:	599%	5.65%	5.62%	545%	5.92%	5.66%	5.00%	6.01%	615%	6.50%	7.00%	750%
	Change (Basis Poluna):	40	-22	0	- 7		4	49	-14	46	-20	-50	750
Com glidel by like o mark	Spead to Cap Pare (Basis Points	40	26	95	2	24	26	24	27	25	25	25	20
	Complet by New merk												

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