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A note from Mike McCune: *Our long time friend and advisor, Ray Wilson, has generously contributed this very timely and insightful article to the Market Monitor. Ray can be reached at (626) 792-2107 with your questions and comments.*

Investor Demand - *Desire to Acquire and Ability to Pay*

The Impact of Class Distinction, Operating Performance and the Capital Markets

by Charles Ray Wilson, MAI, CRE

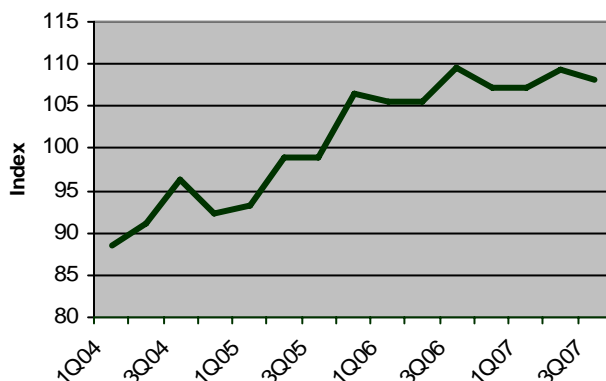
Introduction

Tenant Demand and Investor Demand are both changing for the first time in the history of the self-storage industry thanks to the level of supply of space and the recent softening in operating performance. The level of supply of space, particularly for Class B and C facilities, means tenants have more choices as to where to store their goods, as well as the type of facility they chose to store them in. Changes in investor demand reflects the more recent softening in operating performances and the changes in the capital markets that impacts the leveraged investor’s ability to pay.

Changes in Tenant Demand

Self Storage Data Services, Inc., (SSDS), tracks the level of tenant demand by looking at changes in the Self-Storage Performance Index (SSPI) and its components indices over time. In the 3rd quarter 2007, the index stood at 108.1 (4Q2003 = 100), down 1.2% from the prior quarter and down 1.4% from the same quarter last year. The index is based upon the operating performance of over 5,000 facilities nationwide.

Self-Storage Performance Index (SSPI)



Class Distinction

Historically, owners, investors, lenders and other self-storage participants have not recognized the difference in risk associated with the differences in location and the quality of facilities. The self-storage industry has now reached the point of maturity, (i.e., level of supply of space), that tenants and investors are both starting to notice the distinction between classes of self-storage facilities.

Most tenants and most investors until now have all thought of self-storage as being pretty much the same. Tenants however are learning that there are big differences in what they have to pay to store their goods, and at the same time investors are learning there are big

differences in the risk of ownership between the classes of facilities. Investors are seeing, for instance, that rental growth rates are different among the classes of facilities as are the operating expenses. Both have an impact on their yield expectations given the assumed risk.

Changes in the Investor Market

In Allen Greenspan’s terminology, the “excessive exuberance” of the self-storage market participants over the past few years has subsided, thanks in part to the current capital market correction that’s impacting all types of real estate, not just self-storage.

The self-storage markets specifically are being hit with two events at once. First, the slowing down in performance is causing many owners, particularly owners of Class B and C, to consider selling their facilities. Thus there are more of those classes of facilities on the market today. Secondly, the cost of capital to the leveraged buyers is higher today and underwriting standards have tightened up. This benefits the REITs and other equity investors' seeking to buy stabilized Class 'A' facilities in the major markets, but has a detrimental impact on the market for Class 'B' and 'C' facilities.

The changes in just the past few months have caused investors to pay a lot more attention to property level due diligence because lenders have become a lot more diligent in their underwriting. Even though interest rates haven't risen significantly, tighter underwriting and the wider loan spreads mean fewer loan dollars to the borrowers.

Conclusions

The investment demand for Class 'A' facilities remains strong. Given the amount of capital seeking Class 'A' facilities and only a marginal increase in the cost of capital to these investors, cap rates and therefore values, for these facilities should remain stable.

The investment demand for Class 'B' and 'C' facilities is shifting from a seller's market to a buyer's market because leveraged investors are finding it more difficult to make deals pencil out. The level of investor demand coming from the leveraged buyers will be determined by their willingness to lower their yield expectations and the seller's willingness to lower their price expectations.

SSDS anticipates that investor demand will shift away from the smaller regional leveraged-investors to the public and private equity investors. If Class 'B' and 'C' facilities are to continue to sell, then the investor demand will be dominated by equity-based investors who will look to price facilities on risk-based factors and on segmentation of tenant demand.

Self Storage Data Services, Inc., (SSDS), is an independent research firm that maintains the nation's largest database of self-storage operating statistics. *Charles R. Wilson & Associates, Inc.*, was founded in 1976 by Charles Ray Wilson, MAI, CRE and is now part of Integra Realty Resources, the largest valuation and consulting firm in the U.S. The *Integra Realty Resources – Metro LA* office continues to specialize in self-storage valuation nationwide. For more information, call (626) 792-2107 or visit www.crwilson.com.