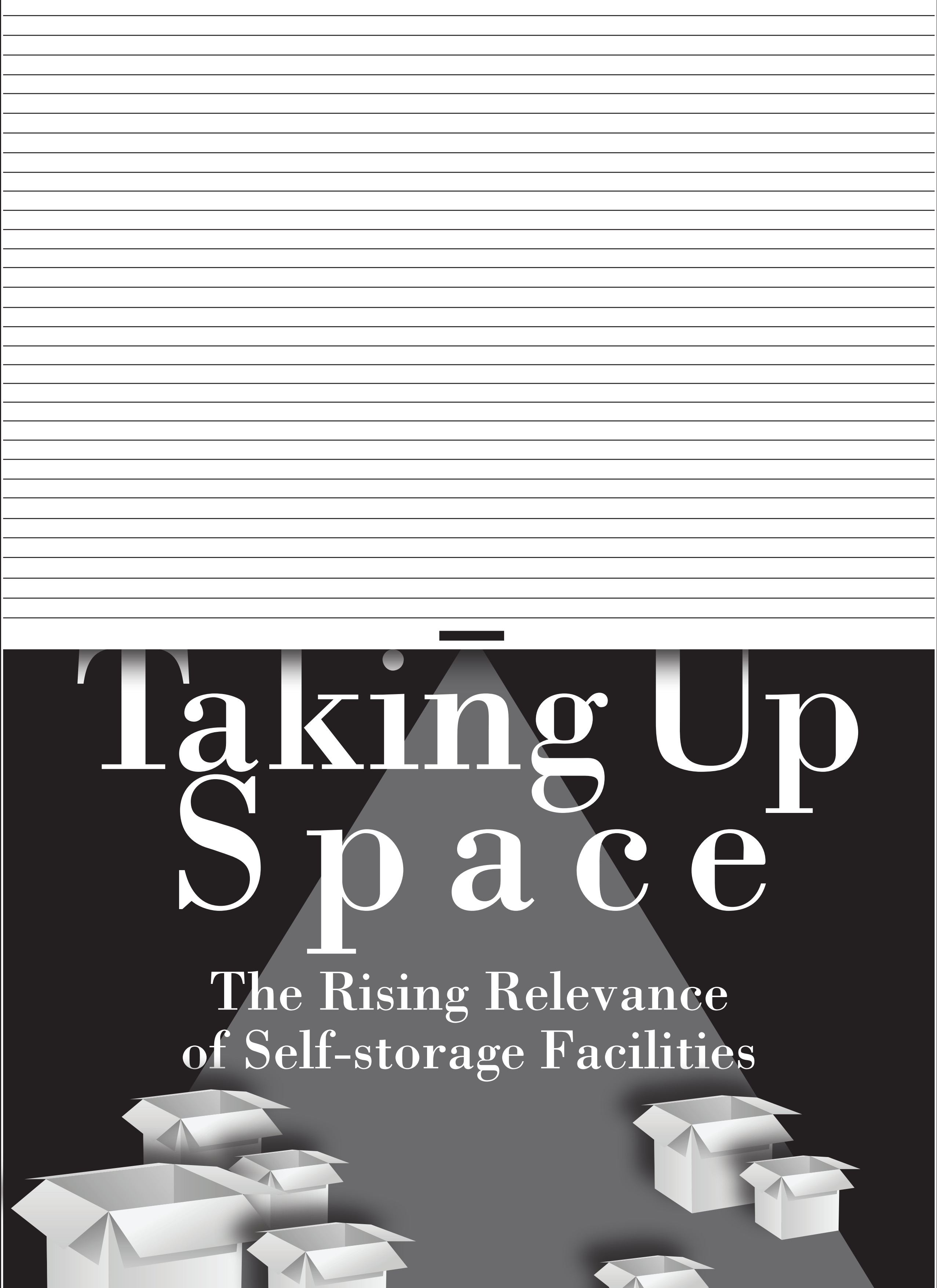

Taking Up Space

The Rising Relevance of Self-storage Facilities

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••The self-storage industry is poised for growth and offers opportunities for lending.

by Nikoleta Panteva and Deborah Stampfli

Standing strong amid the economic turmoil, the storage and warehouse leasing industry has been a unique example of resilience during the past few years.

Since the first self-storage space was introduced in the late 1960s, the industry has demonstrated strong growth, experiencing significant demand when other businesses fared poorly. Because of its strong performance, lenders can look to the industry as a stable opportunity in a fluctuating and unpredictable economy.

Nevertheless, the industry does face potential risks and patterns of uncertainty. Despite a relatively strong performance during the recession, the industry is not countercyclical; indeed, revenue fluctuated and profit margins declined. As spending and overall sentiment sank, consumers had fewer items to store in these facilities, tempering demand. In light of these factors, lenders must be mindful of possible setbacks amid the positive trends for self-storage firms.

Industry Overview

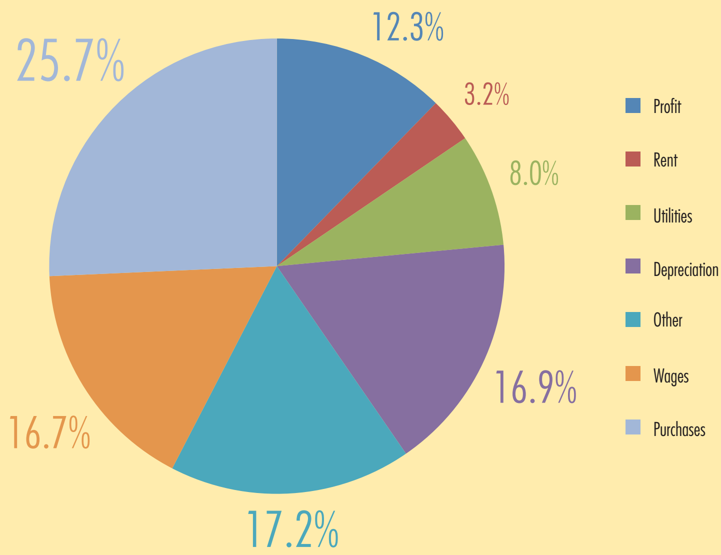
While many industries felt the crunch of the subprime mortgage crisis, self-storage facilities benefited from the accompanying high foreclosure rates. As the housing bubble burst in 2008 and 2009 and housing starts fell 33.2% and 38.8% in those years, respectively (indicating crashing demand for homeownership), consumers looked to the industry for their storage needs.

Despite a relatively strong performance during the recession, the industry is not countercyclical; indeed, revenue fluctuated and profit margins declined.

As a result, demand for self-storage facilities soared and the number of facilities rose accordingly. The total number of industry establishments increased from 42,513 in 2006 to 46,351 in 2011, in light of strong demand and increased foreclosures.

Further, revenue for the storage and warehouse leasing industry rose at an average annual rate of 0.4% during the same period, to reach $22.5 billion. While this growth rate

Storage and Warehouse Leasing in the U.S.



Year	Revenue ($m)	Annual Change
2000	13,627.40	N/A
2001	14,139.20	3.8%
2002	15,740.00	11.3%
2003	17,016.90	8.1%
2004	10,868.30	-36.1%
2005	19,373.30	78.3%
2006	22,010.90	13.6%
2007	23,003.30	4.5%
2008	22,510.30	-2.1%
2009	21,550.60	-4.3%
2010	21,618.20	0.3%
2011	22,463.60	3.9%

is marginal, the industry's overall performance places it in a worthwhile position for lenders.

Characterized by relatively low operating costs and low maintenance costs, the industry's profitability is high, with firms taking home a large chunk of revenue (operators typically bring in about 12.3% of sales as income). Meanwhile, the growing popularity of TV shows like A&E's "Storage Wars" has been a boon to the industry, drawing attention to new revenue sources and supporting demand.

Resilience and Recession

By definition, the storage and warehouse leasing industry rents or leases space for self-storage. It provides secure space where customers can store and retrieve their belongings at their convenience. Therefore, this industry's performance relies on consumers' demand for space and their quantity of goods.

The industry's relatively stable performance during the recession reflects its powerful and unique position in the economy. Despite declining housing starts and soaring foreclosures, demand for storage and warehouse leasing has actually strengthened. Consumers facing foreclosure require storage space for the items that they previously held in their homes, so demand has been consistent with poor performance in the housing market. Revenue still declined 2.1% in 2008 and 4.3% in 2009, but it turned around in 2010 (0.3% growth) and is estimated to have grown strongly in 2011, by 3.9%. This pattern will likely continue in the years to come, with demand for storage facilities remaining secure.

Despite some minor setbacks, the industry is forecast to experience escalating growth over the next five years. In fact, once the economy recovers completely from the recession, the industry is not expected to decline at all. Revenue is forecast to grow at an average annual rate of 3.2%, to $26.3 billion, in the period from 2011 to 2016, including a sharp rebound of 4.6% in 2012.

Demand for storage will increase as consumers' disposable incomes grow. Storage will become less of a luxury for homeowners with many possessions; demand from small businesses that need storage space also will drive revenue. As the industry's markets recover, downstream demand will strengthen, funneling more dollars into storage facilities.

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The number of facilities is forecast to grow to 52,777 in 2016, up from 46,351 in 2011. While this growth may intensify competition among participants, it will also help create opportunities for lenders by way of expansion.

The Costs of Storage

When considering firms in the storage and warehouse leasing industry, lenders must also take into account the costs inherent in public storage. Average operational costs are relatively low, with rent accounting for about 3.2% of revenue, utilities making up about 8.0%, and purchases representing 25.7%.

Still, the cost structure of individual firms varies, depending on the size, structure, and location of the company. The industry is characterized by high profitability, with profit (earnings before interest and taxes) estimated to account for 12.3% of revenue in 2011, reflecting growth from 2010. However, the profit margin is down from 2007, when it constituted 15.2% of revenue.

Despite this drop during the five years to 2011, the industry's profit is surprisingly high. Because operational costs are low, firms benefit from a high percentage of profit to revenue. In particular, storage and warehouse leasing companies have low labor costs, as they rely less on employees because of the industry's self-contained nature.

Labor costs, as a share of revenue, have fluctuated slightly during the past five years, but they remain largely unchanged. For 2011, IBISWorld estimates that labor costs represented 16.7% of revenue, which is roughly the same proportion as in 2006. On average, employment cuts by some businesses have been offset by staff expansions from others that aim to up the competition ante by strengthening customer service.

The industry's costs also include purchases, which make up the largest component of company expenses. These purchases include property maintenance (for example, landscaping and cleaning) and security measures that are not covered by employees. These elements serve a vital function in promoting a particular property. Firms that have invested significantly in their properties can gain a competitive advantage in this respect.

Fewer Goods, Less Demand

As mentioned, the subprime mortgage crisis has played an integral part in the industry's relatively solid performance during the past five years. Although revenue dropped at the height of the recession, the weak housing market helped stimulate demand for self-storage facilities.

In fact, many industry operators experienced an influx of goods into their storage facilities during the recession. Consumers who had foreclosed on their homes or lost them by other means were forced to store their belongings elsewhere. This trend helped bolster demand for third-party storage companies, benefiting operators. However, as the economy bounces back, this previously positive factor will result in a potential threat to lenders. In particular, as access to credit improves, followed by an improvement in the housing market, homeownership is expected to climb back up. This growth could limit the need for outsourced storage locations.

Consumer spending trends also pose a potential threat to lenders looking to the storage and warehouse leasing industry in the years to come. Shaken by drastic declines in personal disposable incomes and a skyrocketing national unemployment rate, consumers have changed their spending habits.

People are more conscious of price and value, and they have not yet returned to the exuberant spending habits of pre-recession America. Consumer spending is expected to experience a slow revival during the five years to 2016, growing about 2.6% per year. In contrast with pre-recession consumer spending increases of 3.5% in 2004 and 5.2% in 1998, this projected growth rate is comparatively low. Therefore, this consistently low level of consumer spending may limit the amount of "stuff" that Americans acquire, shrinking the need for storage outside the home.

An increase in spending may indicate a steady recovery, leading individuals to make more purchases and boosting demand for storage.

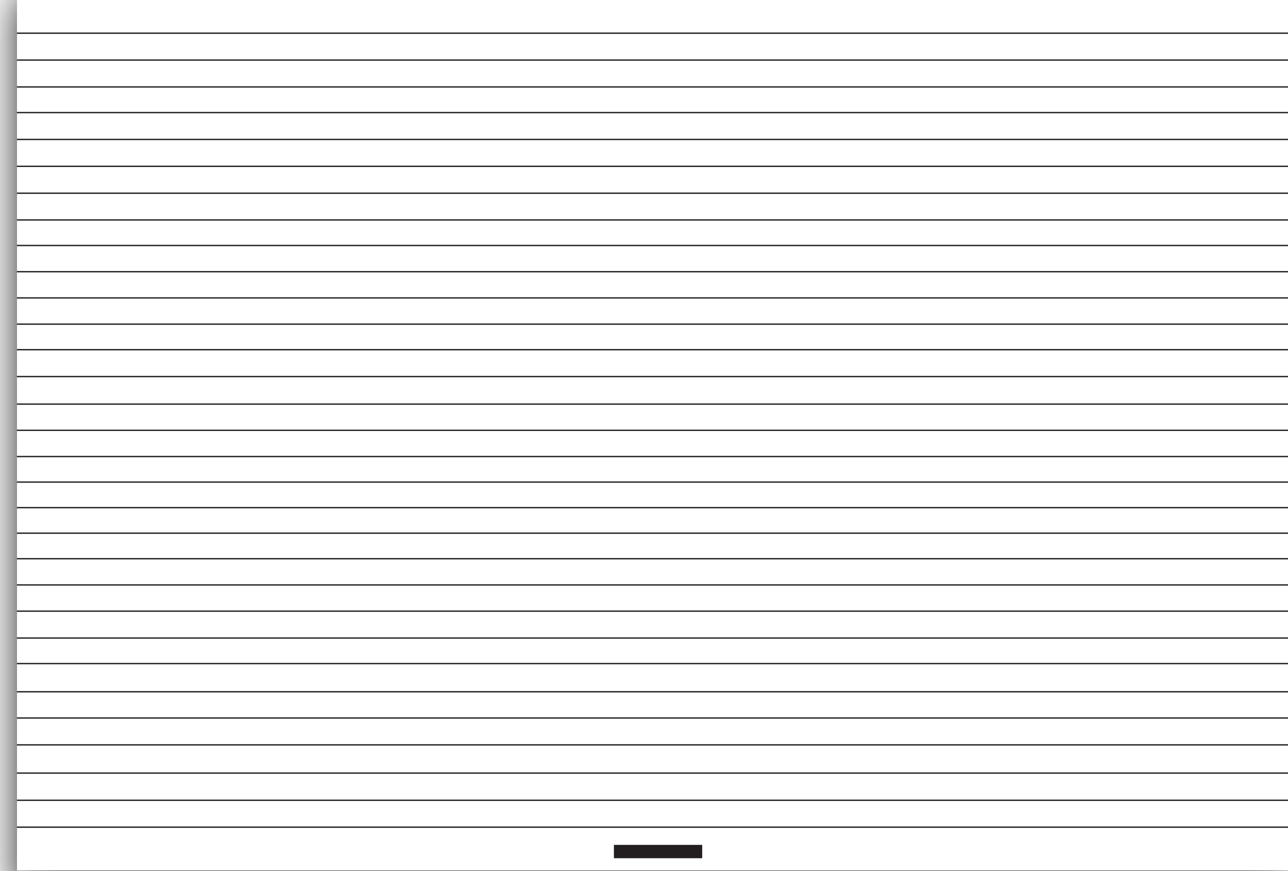
Nevertheless, the positive implications of renewed consumer spending will likely outweigh this threat in the coming years. According to the Bureau of Labor Statistics, consumer spending rose 0.8% in July 2011, the fastest growth since January 2011, outpacing most economists' forecasts. This increase in spending may indicate a steady recovery, leading individuals to make more purchases and boosting demand for storage. Given these factors, the industry will present opportunities for growth over the next five years.

Housing Prices Facilitate Growth

While the housing market will undoubtedly return to growth, the turnaround will be gradual and may not immediately reach pre-recession levels. Prior to 2007, the value of residential construction was well above $700 billion. It fell to a low of $323 billion in 2010 and is not forecast to fully recover during the next five years. IBISWorld anticipates that the value of residential construction will grow to $593 billion by 2016. Since fewer consumers will be buying houses, demand for storage in independent industry facilities will remain. This aspect will sustain demand for out-of-home storage.

Another trend in the housing market may positively influence the industry's performance in the coming years. Specifically, if housing prices begin to rebound faster than unemployment declines, consumers will be limited in their ability to purchase large homes. IBISWorld forecasts that the house price index will grow significantly in 2013 and 2014 (5.5% and 5.9%, respectively). This factor will help storage facilities operators as more consumers demand additional storage space.

While the rebounding housing market may pose some threats to the industry, the turnaround will be more ben-



eficial than harmful to industry operators. As previously mentioned, storage and warehousing facilities are not countercyclical; revenue declined for this industry during the recession, much like it did for most other U.S. sectors. Therefore, IBISWorld expects that a return in consumer confidence and spending will only boost demand for storage facilities.

The Future of Storage

Because of their strong cost structure, business model, and growth opportunities, self-storage facilities will play a vital role in the economy in the years to come. In particular, operational costs (for labor, rent, utilities, and maintenance) remain relatively low, while profit margins are high and will likely grow.

Additionally, the business model for personal storage facilities remains solid. Operators require lessees to sign a short-term contract (usually six months to a year), and they receive monthly revenue from these customers.

Furthermore, the industry features a built-in customer model since most storage facilities serve their local market. They do not have to compete against storage facilities in other states or Internet-only service providers, which makes it easier to obtain customers.

The industry has a low concentration, meaning that no single player holds a significant share of the market. In fact, the largest operator, Public Storage, is estimated to account for just 7.1% of total revenue as of 2011. The second-largest operator contributes a mere 1.4% of total revenue, and about 31,000 industry companies make up the remainder of revenue.

Conclusion

The storage and warehouse leasing industry will likely face substantial growth during the five years to 2016, brought on by a number of factors. The housing market will improve, but it will remain slow, bolstering demand for storage space outside the home.

Moreover, the house price index will grow significantly in 2013 and 2014, limiting the ability of consumers to purchase homes and benefiting storage facilities. An increase in consumer spending will encourage purchases, causing a rise in demand for space to store the items.

And finally, new revenue streams are becoming available to operators of storage facilities. Highlighted by TV shows like A&E's "Storage Wars," facility owners have new opportunities to sell abandoned storage items at auctions.

Nevertheless, lenders must keep informed about the industry's potential risks, staying on top of patterns and trends that may harm operators. Despite the gradual revival of consumer spending, its low growth may limit the number of items that customers will buy and ultimately store in industry facilities. Further, the steady improvement in homeownership rates can hurt operators, since they rely on demand for external storage space.

Still, these trends will not cut into revenue substantially during the next five years, and the industry will continue on an upward trend, with lenders benefiting from its growth. ❖

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