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Self-Storage Demand Is Booming, Generating Huge Gains For Investors

Houston Self Storage
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Buoyed by elevated migration, business disruptions and life changes brought on by the coronavirus pandemic, the self-storage market enjoyed major gains in 2021 — both nationally and across Texas' major metropolitan areas.

Occupancy and rental rates for self-storage units skyrocketed this year in what experts point to as a major turnaround for a state that used to be one of the most oversupplied in the country. And while other traditional asset classes have struggled, the gains generated by self-storage REITs are drawing the attention of institutional investors looking for an alternative place to put their money.

"As long as we've tracked data in the storage industry, we've never seen growth like this," Yardi Matrix Editorial Director Chris Nebenzahl told *Bisnow*.

The pandemic spurred residential migration that led to greater use of self-storage units across the country. Nationally, street rates for climate-controlled, 10 feet by 10 feet self-storage units surpassed record highs in July, growing by an average of 12.4% year-over-year, according to Yardi Matrix's August 2021 National Self Storage Report.

Some of Texas' major cities are reflecting even higher levels of growth. Houston and Austin average rates for the same kind of storage unit were up 19% year-over-year in July, while Dallas-Fort Worth rates were up 12% and San Antonio rates were up 10%. According to Nebenzahl, a normal rate of annual growth would fall between 2% and 4%.

"The four markets in the Texas triangle have done very, very well from an in-migration perspective. And so that has kind of helped boost their storage rates as well," Nebenzahl said.

Another driver for self-storage has been use by small businesses, with many forced to reconfigure spaces and place items in storage. In addition, the huge number of people working or studying from home has spurred conversions of bedrooms into offices or home-schooling areas. Nebenzahl also noted a large rise in outdoor recreation equipment ownership, such as ATVs, RVs and boats.

High occupancy levels have supported rate increases. Yardi Matrix doesn't track self-storage occupancy at the property level, but Nebenzahl said the firm does track occupancy reporting from the publicly traded self-storage REITs, which have reported increases of between 3% and 4% in all major markets.

“If historical occupancies were 90%, 92%, 93% — which I think was a pretty stable, pretty good occupancy level for storage — most facilities are now seeing it at 95%, 96%, 97% and perhaps up from there, on a facility-by-facility basis,” Nebenzahl said.

Those figures are also being seen in Texas, a dramatic recovery for a state that led the nation in self-storage development between 2014 and 2018. During that period, 336 self-storage facilities were completed in Texas, totaling 33.7M SF, Nebenzahl said. As a result, Texas suffered from an oversupply problem that kept rates lower than the national average for years.
Marcus & Millichap Senior Vice President, Investments Dave Knobler is also the director of the firm’s national self-storage group, and he oversees many self-storage deals in the greater Houston area. Knobler told *Bisnow* that rates began to skyrocket about six months ago, when the national vaccine rollout started to pick up steam.

“Everybody's 99% occupied and rates are at an all-time high,” Knobler said.

The national average monthly rate for a non-climate-controlled, 10 feet by 10 feet self-storage unit was $127 in July, according to the Yardi Matrix report. Even with hefty rate increases, Houston’s average rate was still only $92, while Dallas-Fort Worth was $103, San Antonio was $105 and Austin was $108.

Nebenzahl said that the longer people are in a remote work or hybrid work situation, the longer that they will end up using storage units. In his opinion, many people initially thought their use of self-storage would be short-term, but the lengthening timeline for the return to offices and schools has disrupted those expectations.

“We really haven't seen that reversal, that drop in occupancy, that drop in storage utilization. So the REITs seem quite optimistic that this will continue, at least for the foreseeable future,” Nebenzahl said.

Soaring occupancy and rates have yielded significant investment gains this year. The FTSE Nareit All Equity REITs Index indicated that as of Sept. 3, self-storage REITs showed year-to-date returns of 55.7% — a higher rate of return than any other type of REIT included in the index.
Similarly, the Dow Jones U.S. Select Short-Term REIT Index showed that as of Sept. 8, year-over-year returns were 58%. That index includes REITs in property sectors that typically have short-term lease durations, such as self-storage.

Knobler said he has seen a lot of new entrants to the self-storage space, including institutional investors with serious funds.

“They're really pushing out the traditional individual investor that might want to come in and get a return," he said. "It's not impossible or anything, but you're seeing a totally different cut of money coming into the space. And they like the security, they like to hedge against inflation."

Self-storage facilities are attractive because they allow for much faster rental rate increases than other types of assets, which protects investors from market shocks and inflationary pressures. That flexibility, combined with rising demand from migration and other ancillary drivers, is attracting investors from traditional asset types.

Devon Self Storage Senior Vice President, Investments Raheem Amer said that for his firm, revenue is rising across all locations, including in Texas. Devon has 11 self-storage properties in Texas and more than 40 other locations in other states.

However, because of the sector’s success, self-storage properties are selling for record prices. Amer said that has made acquisition strategy difficult, particularly with several private equity investors also chasing investments in the space.

"At Devon, we have shifted to conversion strategy," Amer said. "We are targeting box retailers that have closed in the last couple years and are focusing on converting these into self-storage. The cost to get into conversion is extremely low, compared to acquisition or building from scratch."

For all the interest, gains in the self-storage sector haven't led to a huge development spike in Texas yet. As of July, Houston had 2.3% of its existing self-storage inventory either planned or under construction, sitting at the bottom of the list of top 30 markets tracked by Yardi Matrix. Other Texas markets fared slightly better: San Antonio had 4%, Austin had 5.9% and Dallas-Fort Worth had 6.6%.

In comparison, the national pipeline had 8.5% of its existing inventory either planned or under construction, with New York City leading the country at 18.3% in July.

Knobler said that self-storage development in Texas had a break for a year or two, between lenders being skittish because of Covid-19, the existing oversupply and rising construction costs. However, he predicted it won't be long until it's full speed ahead on development again.

Nebelzahl said he was surprised there hasn't been a major increase in development activity yet, but he is expecting that to change, particularly if self-storage continues its growth streak.

"If these fundamentals stay at such elevated levels, I think we absolutely will see those developers come out of the woodwork," Nebenzahl said.

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