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Nunez Self Storage Report

Welcome to the *Nunez Self Storage Report*, and our first of the year and oh my, what a year it has been so far. For an industry that relies on transition with a peak season of spring and early summer, COVID-19 could not have come at a worst time. The loss of mobility from Shelter-in-Place orders has prevented move-ins and stalled occupancy rates in most U.S. markets. In some cases it has slowed rent collections, also. Extra Space Storage reported, for example, that it collected 93 percent of its rents in April compared with 98 percent in April a year ago. This isn't to say that it is going to be "a lost year" for Self-Storage, as it is for some industries – like travel and tourism. No, the virus is wreaking havoc on our economy but eventually we will start recovering and the same elements that drive demand for storage units will come back and new uses will be created as a result of this situation.

New Development - Sundance Self Storage • Buckeye, AZ

Economic Overview & Factors

As a contrast to the national market, much of Arizona properties are adjusting to these new challenges. Diane Gibson, President and Owner of Cox Armored Management which operates 18 Self-Storage properties throughout Arizona, states that it is almost business-as-usual. Cox Armored has adjusted to the National Self-Storage issued guidelines which recommended no rental rate increases, no auctions and no late fee charges. Gibson states that most of her facilities have remained in the mid-90's in terms of occupancy. And while some submarkets have shifted somewhat lower while others higher, properties with declining occupancy are probably being
impacted by the new supply coming online. Gibson further stated that they are working with their tenants in terms of late payments and in some cases the stimulus checks have allowed tenants to catch up with their past due payments.

The biggest question on everyone's mind is how deep and how long will this recession last? First quarter GDP declined at an annual rate of 4.8 percent and economists expect the second quarter contraction to be anywhere from negative 20 percent to negative 40 percent, or the worst contraction since the Great Depression. For the year 2020, the Congressional Budget Office expects GDP to end up at negative 5.6 percent but bounce back slightly positive to 2.8 percent in 2021 (that is anemic quarterly growth) and for consumer and business spending to not reach pre-pandemic levels until 2022. Some economists are more optimistic and expect a hard 'V' dip and rise to GDP, with robust growth in the economy the second half of this year. ASU economists predict a recession of 3 to 9 months and a swift recovery by early 2021. The truth is, no one has ever seen this movie before so we don't know how it ends, but it will end. All cycles do.

Arizona did not escape the sudden rise in jobless claims. From the depths of the recession in 2010, 631,000 jobs were added to the state's economy through the beginning of this year and in recent five-week span beginning in late February, 418,016 Arizonans filed for unemployment. However, the state is poised to weather this storm better than most U.S. states. The 2019 U.S. Census estimate ranked Phoenix-Mesa-Chandler as the 10th largest MSA (metropolitan statistical area) in the U.S. and in the top 10, Phoenix was the third-fastest growing in the country, adding 18.01 percent to its population since the 2010 Census. Only Houston (19.35%) and Dallas-Ft. Worth (18.95%) grew at a faster clip. The nationwide economic plunge (and health concerns/fears in dense urban areas) caused by the pandemic is bound to drive an even faster exodus from some states, particularly California. As Arizona Gov. Doug Ducey recently stated, "Arizona was leading in economic momentum heading into the downturn, and Arizona will lead the way out." Arizona has greatly diversified its economy in the last 10 years, even being dubbed "Wall Street West' for all of the financial institutions with a presence in Arizona. Further, the state will be a net beneficiary when the U.S. reinvents its supply chain and "re-shores" many of those business functions back to North America from Asia.

New Investments & Jobs Coming to Arizona

Governor Ducey announced in mid-May that following a national search, Taiwan Semiconductor Manufacturing Company (TSMC) has selected Arizona for its new U.S. advanced semiconductor factory. The project will create over 1,600 new high-tech jobs and generate thousands of additional jobs in the state for suppliers and other companies within the semiconductor industry. TSMC's total spending on this project, including capital expenditure, will be approximately $12 billion from 2021 to 2029.

In addition, Zoom plans to build a new research and development center in the Phoenix-area, creating hundreds of high-wage jobs.

Company representatives said they don't have a specific location yet, but they want to be close to Arizona State

New Investments & Jobs Coming to AZ Cont.

University since it's the university's engineering program that attracted Zoom to the area. According to the company, employees will work from home until the offices are built and COVID-19 risks have declined, saying they're expecting that in fall 2020.

Phoenix and Tucson Market Conditions

The Coronavirus' impact on the Self-Storage markets is not unlike what has happened with other property sectors, including office, industrial and especially retail properties – transactions ground to a near halt in March. Some that were close to the finish line got done. Others paused, or fell apart altogether as uncertainty and fear took over. Bank lending slowed and access to capital overall has been difficult. Yet deals got done, particularly with 1031 exchanges and cash buyers.

Development projects in the pipeline were frozen or put on hold, especially if financing was necessary, and not yet secured. Construction continued, however, for projects underway. We expect new supply to substantially diminish for the foreseeable future – an unexpected positive to some markets which were seeing oversaturation and slower lease-up periods. Projects will have to be in Class A locations with limited or no competition within a 3.0 mile radius in most areas. It would not be surprising to see that standard raised to a 5-mile radius in some submarkets.

<u>In Phoenix and Tucson, here are the numbers at the close of the first quarter 2020:</u>

- New Facilities Under Construction: 28
- Proposed New Self-Storage Projects: 78
- Existing Properties Undergoing Expansions or Additional Phases: 3
- Proposed Expansions for Existing Facilities: 21
- Projects on Hold: 5

National Self Storage News and Trends

According to Real Capital Analytics, 2019 sales of Self-Storage properties increased 9 percent year-over-year to $5.6 billion. Given the environment we expect sales to be flat this year and perhaps show some level of decline. In part, as we emerge from the first stage (and hopefully the only one) of the post-COVID economy, there could be a pricing disconnect between sellers and buyers. Sellers may be thinking of January-February valuations. Buyers, regardless of asset type, are going to be looking for discounts.

Occupancy levels at local Self-Storage properties remain high – from the high-80s to +90 percent in most cases at the close of the first quarter. However, average occupancy rates are likely to dip into the mid-to-high 80s as we get deeper into the year. Revenue growth is expected to be flat for the remainder of the year. For most Self-Storage operators, particularly the national REITs, revenue growth is typically achieved with existing customers in the form or incremental rental rate increases. CUBE, Life Storage Inc., Public Storage and Extra Space have all reported that they have temporarily suspended rental rate increases.

Future supply and investment opportunities will likely be in secondary and tertiary markets as the national developers, regional players and local mom n' pops seem to have created enough supply in the top 25 metro markets. For example, we're bringing to market a Self-Storage property in Huntley, Illinois, population 27,000, which is a suburb of Chicago 45 miles northwest. Yet Huntley has one of the fastest growing populations in the Midwest with lots of new subdivisions already opened and more being built. We anticipate an active buyer pool for this property.

Highlight: Self-Storage as an Asset Class is Attracting New Investors

In mid-April Clearwater, Florida-based Opp Zone Capital LLC launched OZC Southern US RE Qualified Opportunity Fund and is seeking accredited investors for mixed-use, multifamily and Self-Storage development in the Southeast and the Southwest. The fund is authorized to raise $40 million for opportunistic zone acquisitions, citing interest in secondary and tertiary markets including Mesa, AZ, Tampa, San Antonio, Houston and Atlanta – all population-growth centers. One of the fund principals stated in a press release that they "project that multifamily and Self-Storage offer the greatest immediate opportunities for the fund."

Self-Storage has a history of being a port in the storm for real estate investors so it is not surprising that the sector is drawing new interest. If self-storage emerges as a strong sector during a coronavirus-inspired slowdown or recession, it would follow the pattern of the sector's behavior during the Great Recession. In 2008, the NAREIT All Equity Index lost roughly 40 percent of its value across all sectors, while self-storage REITs returned 5 percent.

Questions?

Contact the Nunez Self Storage Investment Group for more information regarding exclusive listings and market trends.

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