Self-Storage Development in the Wake of the 2016 Boom Bubble Burst

From 1994 to 2014, self-storage REITs (real estate investment trusts) delivered 18 percent annualized returns with lower volatility than their REIT counterparts. For more than a decade, new self-storage facility development nationwide was abundant, and there seemed to be no end in sight. In 2015, self-storage construction spending rose by 73.3 percent across the U.S. surpassing the billion-dollar mark for the first time since 2008.

By the end of 2016, however, the self-storage sector found itself facing new challenges that spilled into 2017, starting with a growing number of municipal zoning boards hungry to curb self-storage development in their communities. New York City, San Francisco, and Charleston, South Carolina enacted policies that limited the development of self-storage facilities. Self-storage developers in the "hot spot" state of Florida, where high demand from under-served residents and seasonal visitors kept self-storage construction companies busier than ever before, were stymied by new zoning restrictions in key areas like Miami and Collier County. Tighter REIT regulations enacted in 2016, rising interest rates, and other obstacles placed self-storage developers under increased pressure to step back and review their options.

Many developers devised innovative approaches to appease local regulatory boards, gain a new perspective on market trends, and design facilities that are appealing and community-enhancing in order to win over zoning officials.

Throughout the U.S. and in Florida, barriers to self-storage development in some cities suddenly became complicated and perplexing; by taking a strategic, informed approach to tackling regulatory and zoning challenges, many developers helped establish new niche markets in facility architecture and design that adapted to the communities they would serve.

While development challenges and stricter REIT requirements tempered growth expectations for 2017, the perpetually outperforming self-storage sector reclaimed its footing this year, gaining 6 percent and outpacing the REIT index. It also created a niche for specialist REITs in the self-storage sector and opened new opportunities for investors.

Vigorous demand for storage space is expected to drive further development and sustain rental rate increases. In 2017, the average rental rate for climate-controlled storage space will rise 2.7 percent to $1.63 per square foot, building on a 1.6 percent increase in 2016. The average rent for non-climate-controlled units will climb 3.0 percent to $1.31 per square foot in 2017, following a 3.1 percent gain in 2016.

While the self-storage industry has decelerated its pace from one of rampant expansion to a more moderate, sustainable growth trajectory, the underlying drivers of self-storage development endure. Demand for storage facilities continues to increase both nationwide and in Florida, while mounting supply shortfalls represent a growing concern. New supply has been insufficient to overcome burgeoning demand, and construction could have a greater influence in the development cycle.

Favorable demographic trends and a consistently healthy growth of the multifamily market will further stimulate need for storage space. Steady population growth and climbing incomes cultivate a diverse and expanding self-storage tenant pool, which includes record numbers of baby boomers retiring and downsizing as millennial households emerge in greater numbers—all of whom need storage for their excess belongings.

In 2017, self-storage development, both nationally and in Florida, won't see the extraordinary growth experienced between 1994 and 2015, but it will persist on a path of consistent, albeit moderate growth. It will continue to provide the industry with rent growth, which will be significant in regaining its previous strong market standing. Rent growth is expected to step up again in 2017, following seasonal patterns.

U.S. Census data analysts found that the value of new self-storage construction increased sharply in 2016, to about $2 billion—almost double the value in 2015.

And despite resistance from public officials, new self-storage development has accelerated nationwide. Data does not appear to indicate that the sector will endure an absorption issue since supply has not reached historic levels.

The market's fundamentals are solid. Following the slump in 2016, the national marketplace witnessed two self-storage portfolio deals totaling more than $30 billion alone. Moving forward, keep in mind that self-storage development is becoming increasingly integrated with more concentrated, higher density residential development whose tenants and home buyers place a high value on convenient storage solutions.

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