Coronavirus Impact Creates a New Reality for Self-Storage Investing

Though the full economic impact of the coronavirus is yet to be measured, the pandemic has already disrupted the finance and investment markets. Read how the crisis will likely affect self-storage owners and investors.

Ben Vestal | Apr 23, 2020

There's never a dull moment during this coronavirus pandemic. With circumstances changing so rapidly, it's difficult to tell how things will be tomorrow, let alone six months from now. There are many questions for which we have minimal answers, and it's impossible to understand the full impact of the health crisis as of this writing (April 1).

The acceleration of COVID-19 and the accompanying anxiety over the past few weeks have made most recent economic reports irrelevant. The shock experienced within the financial markets is likely to reverberate through at least the next few quarters. The one thing I do know is we'll get through this crisis, and the self-storage sector will emerge stronger and better defined as part of our country's critical infrastructure. Our industry is essential even now, providing services to a multitude of trades and a solution for many Americans who now find themselves forced to work from home and create space for their makeshift office.

As we monitor the impact of the coronavirus across the self-storage landscape, I'd like to examine some key points regarding the rapidly changing investment markets. I'll also offer some predictions for owners and investors who are navigating current conditions.

Investment Outlook

As of April 1, the uncertainty of the markets has put pressure on investors to find a safe haven. Self-storage returns will be higher and more predictable than those of alternatives like hospitality, retail, office, cash and stocks, so buyer demand continues to be strong. This'll keep capitalization (cap) rates low for the time being. However, I expect debt spreads to temporarily widen over the coming weeks. Banks will be more conservative. We've seen the commercial mortgage-backed securities (CMBS) market hit pause as everyone attempts to get their arms around the impact of the crisis, which will push cap rates upward.

Lending benchmarks remain near historic lows, and we've seen many lenders implement "floors" on interest rates, with most CMBS lenders sitting out the market until things calm down. This lack of willingness to transact will put pressure on property values. Additionally (and as expected), construction lending has tightened substantially in the last few weeks, bring a halt to most new development.

Market uncertainty has put most of the investment world on hold and left everyone wondering what'll happen with property values and cap rates. This leads me to believe that if you're looking to transact in the next 30 to 60 days, you'll need to be patient and allow more time for due diligence. If you're a seller, you may need to accept a discount because buyers are unable to see how things will look in the next few months. We expect transaction velocity to be slower in the near future, but then it should rapidly improve, with a robust rebound.

Of course, it's clear this temporary disruption will create some opportunities. The current investor/buyer pool varies widely from "I'm out of the market and nervous about the future" to "I'm hunting for deals and ready to buy!" Some even have *cash*! The good news is there are still more buyers than sellers.

Industry Outlook

Right now, it's too soon to tell how the coronavirus will affect self-storage rental rates, occupancies and operating expenses, but with a meaningful disruption in the economy, we expect to see a slowdown in revenue and a flattening of net operating income over the next few quarters. This is largely due to an expected increase in delinquencies from tenants who've lost their jobs as well as the inability to aggressively raise rents on in-place customers. Tenants have become increasingly price-sensitive due to the economic uncertainty, and operators must be mindful of price-gouging legislation in their areas.

The silver lining is our industry will see a temporary push in demand from customers who've been forced to work from home and need more space, college students who need to store possessions after vacating campuses, and others who've been displaced due to layoffs. With the spring/summer rental season right around the corner, we're hopeful this will soften the landing.

Self-storage has some business advantages that'll prove meaningful during the next several quarters, too. These include a large, granular tenant base that's very resilient and the industry's ability to react quickly to the market and create demand by raising or lowering rental rates. The self-storage business model allows us to be more responsive to customer needs than other real estate sectors.

As we emerge from this crisis, self-storage will again prove itself as a real estate asset class that's very resilient during economic downturns and able to provide investors with a reliable, stable return. I believe that by the time second-quarter earnings come out in mid-July, our industry will once again be the shining star of commercial real estate!

People continue to amaze me. In the few weeks since this crisis began, I've seen great compassion, generosity and kindness between complete strangers. This reassures me that we're all in this together, and I have no doubt we *will* get through it. There's going be disruption and inconvenience for a while, but as we saw after 9/11 and the Great Recession of 2008, we'll pull together as a nation, and the self-storage industry will lead the way.

I hope you and your families are staying safe and healthy during this unprecedented time.

Ben Vestal is president of the Argus Self Storage Advisors, a national network of real estate brokers who specialize in self-storage. Argus provides brokerage, consulting and marketing services to buyers and sellers via an extensive marketing platform for self-storage properties. Property listings and informational resources can be found at www.argus-selfstorage.com . For more information, call 800.55.STORE; e-mail bvestal@argus-realestate.com .

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