Market Focus

Chicago’s Self Storage Market

Institutional and private capital has discovered the Chicago-area self storage market. The majority of quality self storage properties are now acquired by operators and investors based outside Chicago due to a number of factors. First, the permitting and zoning approval process for new self storage developments in desirable locations remains lengthy. Additionally, strong competition for acquiring properties located on both the East and West Coasts is leading investors to this market seeking better returns and greater market share.

STATE OF THE MARKET

The Chicago area remains below the national average in terms of existing self-storage supply. According to the 2006 Self Storage Almanac, Chicago has a supply of only 2.67 square feet of self storage per person, compared to a national average of 5.54 square feet per person. The estimated local demand puts Chicago’s supply versus demand in a range of equilibrium to under-supplied, suggesting opportunities for new development in certain submarkets. However, these macro views are best used as a benchmark since conditions vary significantly from one neighborhood to another. Self storage remains a provincial retail business, and new self storage competitors entering a submarket may negatively impact the financial performance of existing properties.

INVESTMENT MARKET

Over the past few years, nearly every time a self storage facility or portfolio has been placed on the market for sale, multiple potential buyers flush with institutional capital have been aggressively bidding. Cleveland-based U-Store-It, which went public in 2004, completed its first post-IPO acquisition by paying $184 million for the Metro Self Storage portfolio of 42 facilities totaling 2.6 million rentable square feet. The portfolio, with occupancy of 83.6 percent, translates to a capitalization rate of about 6.86 percent, and includes 24 Chicago-area properties.

New supply data for self storage space remains fairly scarce. However, construction costs for self storage properties, similar to other property types, have increased sharply over the last 12 to 24 months. The limited new supply coupled with slowing development from national operators has investors nationwide willing to take on leasing risks of new and existing facilities. StorageMart of Columbia, Missouri recently sold a portfolio of four newer facilities prior to stabilized occupancy for $39.2 million. The properties located in Chicago, Bolingbrook, and Countryside range in price from $66 per square foot up to $158 per square foot.

Metro Self Storage recently acquired a vacant, state-of-the-art, multi-story facility in downtown Chicago consisting of approximately 97,000 rentable square feet. The $11.5 million purchase price for the newly opened facility translates to about $118 per square foot. MJ Partners recently sold a Metro Storage facility with stabilized occupancy located in Lake Zurich, Illinois to a New York-based investor for about $114 per square foot and a record-low 5.6 cap rate.

MEGA DEAL

Public Storage, Inc. based in Glendale, California is the largest U.S. self storage company and seventh largest equity REIT overall and remains Chicago’s largest operator. Currently, Public Storage operates 104 facilities throughout Chicago consisting of about six million square feet. In 2005 Public Storage replaced Delta Air Lines in the S&P 500 index, further raising the sector’s profile among national and foreign investors. Public Storage recently announced a $5 billion acquisition of Shurgard Storage Centers, the Seattle-based REIT and fourth largest operator. The transaction is scheduled to close at the end of the second quarter 2006, and includes 23 facilities located throughout Chicago. The total transaction equates to a 5.9 cap rate, and consists of 634 properties with 134 located throughout Europe.

SUMMARY

The Chicago self-storage market has matured over the past decade with more-professional facilities, greater industry-wide information and more-sophisticated market analyses. These factors contribute to a new wave of institutional investor interest in the sector. Despite the industry’s recent growth, most of the market is fragmented and still owned by private individuals. The sector should remain attractive for institutional investors seeking stable cash yields and we anticipate further cap rate compression. With limited new supply, increasing demand as the economy expands and growing investor interest, self-storage investment throughout Metropolitan Chicago is poised to perform well over the next few years.

Rate Check

The U.S. real estate market continued to benefit from extraordinary liquidity in the capital markets during the first quarter of 2006, and from the fastest economic expansion in two years. Led by resurgent consumer spending and the biggest jump in business investment since 2000, the economy grew at a 4.8% annual rate.

DEBT MARKET

Conditions in the real estate debt markets changed very little in the first quarter, despite rising short-term and long-term interest rates. After starting the year below 4.4%, the yield on the 10-year Treasury bond climbed above 5% for the first time in nearly three years. Commercial mortgage originations and securitizations continued to surge as transaction and refinancing activity showed no signs of abating from last year’s torrid pace. The U.S. commercial mortgage-backed securities (CMBS) volume soared to $45.5 billion in the first quarter representing a nearly 50% increase from last year, leaving little doubt that 2006 will be another blockbuster year in the debt markets. While rising interest rates and lower yields on property might weaken borrower demand, loan terms remain very favorable and combined with a booming
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In the transaction market, the chances of a sudden slowdown seem remote. More capital sources are converging on the real estate industry, constrained only by borrower demand.

Regulatory agencies including the Federal Reserve, FDIC and Treasury Department have expressed concern about banks’ exposure to commercial real estate loans. So far, the liquidity in the private equity markets has more than compensated for any bank loan concerns. Although, if private equity and broader capital markets dry up, conditions could quickly change.

PROPERTY MARKET

The ample liquidity in the transaction market has pushed capitalization rates to record lows. The market recovery, with vacancy rates in every major property type trending lower from last year, justify some of the optimism on the part of real estate investors. New development remains largely in check due to high land prices and increasing construction and labor costs, which have driven replacement costs faster than prices for existing assets.

As always, the outlook for the U.S. real estate market is not without risk. Rising capital values have caused yields to compress to historically low levels, with lower expected returns. With property market fundamentals improving and the risk of new supply still fairly distant, real estate investment remains attractive particularly for investors seeking stable yields.

Notes

MJ PARTNERS SALES/FINANCINGS/LEASES


◆ Plum Creek Supportive Living Facility, Rolling Meadows, Illinois. Affordable housing tax exempt bond financing, 127 beds. $11,600,000 tax exempt 30 year bonds at 6%. $2,800,000 tax credits

◆ U-Stor-It Self Storage Portfolio, Buffalo Grove, Elgin, Arlington Heights, Illinois. 173,745 sq. ft. 1,843 units. Sale Price: $15,120,000

◆ Metro Self Storage, Lake Zurich, Illinois. Single-story 69,425 sq. ft. with 514 units. Sale Price: $8,000,000

◆ StorageCenter, Deerfield, Illinois. Three-story 56,905 sq. ft. with 524 units. Sale Price: $6,500,000

◆ 9800 S. Western Avenue, Chicago, Illinois. 3,200 square foot pad site with drive-thru for Dunkin Donuts. Ten-year term starting rate $25.00 net

◆ One South Wacker Drive, Chicago, Illinois. 9,458 square foot tenant representation. Special Risk Service Group. 5-year lease extension and office expansion, mid-teens net

◆ 601 W. Polk Street, Chicago, Illinois. 10,000 square foot tenant representation for Fastroot International. 6-year term, mid-teens net

MJ PARTNERS NEW LISTINGS

◆ One Hawthorn Place, Vernon Hills, Illinois. Four story, 84,592 sq. ft., Class A multi-tenant building. Located along Route 60 in Lake County adjacent to Westfield Hawthorn Mall. List Price: $12,500,000

◆ Two Chicago Loop Office Buildings, Chicago, Illinois. 20 & 28 E. Jackson Boulevard. 16 story, 55,628 sq. ft., 100% leased; 19 story, 87,650 sq. ft., 91% leased. List Prices: $6,675,000 and $10,000,000


◆ 1050 W. Cermak, Chicago, Illinois. 42,700 sq. ft., industrial building in Pilsen neighborhood. List Price: $2,350,000

◆ Net-Leased North Shore Retail Center, 1834-36 Glenview Road, Glenview, Illinois. 8,247 sq. ft. 100% leased new retail center. List Price: $2,950,000

◆ Safe-T-Stor Self Storage, Frankfort, Illinois. 43,236 sq. ft., 294 units, expansion potential. List Price: $3,000,000

OTHER NEWS

◆ David Edward Kohn has joined MJ Partners as a Senior Associate specializing in investment real estate acquisitions, dispositions and leasing.