HISTORICAL CURRENTS

CURRENT TRENDS

Five Forces Affecting the Self Storage Industry

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Arlen Nordhagen
SecurCare Self Storage
About Me

25 Years in Self Storage

• Founded SecurCare in 1988
  - Private self storage company with ~150 properties in 11 states
• Founded MMM Healthcare
  - Largest Medicare HMO provider in Puerto Rico
• Managerial Experience
  - Dupont • Synthetech • American Business Advisors
• Engineering and Business Education
  - MBA, Harvard University • Chemical Engineering, U. of N.D.
THE SELF STORAGE INDUSTRY

- How have we done so far?
- What does the future hold?
- Shepherding the industry forward.
How have we done so far?
Since 1994, NAREIT has measured the performance of public REITs in separate sub-sectors of real estate.

- Self Storage
- Office
- Industrial
- Retail
- Apartments
- Lodging / Resorts
- Healthcare
- Specialty
### The NAREIT Apartment Sub-Sector

How does Self Storage compare to the “Gold Standard”?  

Apartment REITS are the “investor darlings” of Real Estate.

<table>
<thead>
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- **NAREIT Apartment Sub-sector**

Last 19 Years
The NAREIT Apartment Sub-Sector

How does Self Storage compare to the “Gold Standard”? 

Self Storage has been quietly stealing the show!

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NAREIT Apartment Sub-sector

NAREIT Self Storage Sub-sector
Self Storage Outperforms all Sectors
Examining risk and return across all NAREIT sectors

Self Storage has had the HIGHEST RETURN and LOWEST RISK

Graph showing Self Storage as the Best in Class with the highest return and lowest risk compared to other sectors such as Apartments, Retail, Healthcare, Industrial, Lodging / Resorts, Specialty, and Office.
Historically a Great Investment

17.5x cash on cash in 19 years

Value of $100 Invested in Each NAREIT Sector in 1994

Storage Sector: $1,748
Why the Outperformance?
Can we explain the performance with Economics 101?

Undergrad Economics 101:

Demand Growth > Supply Growth = Improved Pricing Power

When product demand growth exceeds product supply growth in an industry (i.e. excess supply contracts), that industry tends to have improving pricing and outperforms.
Why the Outperformance?
Can we explain the performance with Economics 101?

Undergrad Economics 101:

Demand Growth > Supply Growth = Improved Pricing Power

English: When lots of customers want a storage space, but there are only a few left, operators can charge more.
Why the Outperformance?
Can we explain the performance with Economics 101?

Self storage has experienced strong demand growth.
(Lots of customers want storage space)
Why the Outperformance?
Can we explain the performance with Economics 101?

BUT, self storage supply growth has outpaced demand growth! (Despite demand growth, there has been more than enough - actually too much - storage capacity to go around)
So... Why the Outperformance?
Can we explain the performance with Business School 201?

Undergrad Economics 101:
Business School 201:

Five industry forces combine to determine the overall profitability of an industry*:

1. Bargaining Power of Customers
2. Intensity of Competitive Rivalry
3. Bargaining Power of Suppliers
4. Threat of Substitutes
5. Barriers to Entry

* Michael Porter - Harvard Business School
Elements of Industry Structure

Entry Barriers
- Economies of Scale
- Proprietary product differences
- Brand identity
- Switching costs
- Capital requirements
- Access to distribution
- Absolute cost advantages
  - Proprietary learning curve
  - Access to necessary inputs
  - Proprietary low-cost product
- Design
- Government policy
- Expected retaliation

Rivalry Determinants
- Industry growth
- Fixed (or storage) costs/ value added
- Intermittent overcapacity
- Product differences
- Brand identity
- Switching costs
- Concentration and balance
- Informational complexity
- Diversity of competitors
- Corporate stakes
- Exit barriers

New Entrants

Suppliers

Industry Competitors

Intensity of Rivalry

Threat of New Entrants

Bargaining Power of Suppliers

Substitutes

Determinants of Substitution Threat
- Relative price performance of substitutes
- Switching costs
- Buyer propensity to substitute

Determinants of Supplier Power
- Differentiation of inputs
- Switching costs of suppliers and firms in the industry
- Presence of substitute inputs
- Supplier concentration
- Importance of volume to supplier
- Cost relative to total purchases in the industry
- Impact of inputs on cost or differentiation
- Threat of forward integration relative to threat of backward integration by firms in the industry

Determinants of Buyer Power

Bargaining Leverage
- Buyer concentration versus firm concentration
- Buyer volume
- Buyer switching costs relative to firm switching costs
- Buyer information
- Ability to backward integrate
- Substitute products
- Pull-through

Price Sensitivity
- Price/total purchases
- Product differences
- Brand identity
- Impact on quality/performance
- Buyer profits
- Decision makers' incentives

Buyers

Threat of Substitutes

Bargaining Power of Buyers

Threat of New Entrants
Why the Outperformance?
Can we explain the performance with Business School 201?

Five Industry Forces in English:

1. **Bargaining Power of Customers:**
   How much leverage do customers have in influencing price and terms when purchasing from industry participants? E.g. airline vs. NFL tickets.

2. **Intensity of Competitive Rivalry:**
   How “cutthroat” are the industry competitors in waging price wars against one another? E.g. PC’s vs. premium chocolate candies.

3. **Bargaining Power of Suppliers:**
   How much leverage do industry suppliers have in influencing price and terms when selling to industry participants? E.g. specialty vs. commodity chemicals.

4. **Threat of Substitutes:**
   How easily can the product be replaced by the customer with other products?

5. **Barriers to Entry:**
   How difficult is it for new competitors to pop up?
Why the Outperformance?
Self Storage: Five Forces Analysis


• High switching cost for the customer.
• Relatively small purchase as a % of total spending.
• Lots of small, fragmented customers.

Storage Industry Score: 
Great Score
Why the Outperformance?
Self Storage: Five Forces Analysis

2. Intensity of Competitive Rivalry: V. Low.

• Competition limited by geography and high switching costs.
• Small dollar contracts create little incentive for price wars.
• Strong demand growth.

Storage Industry Score: 
+ +
Great Score

- Historically, the only higher $$ unique suppliers were the yellow pages producers
  - They had limited contact with ultimate storage customer
- All other suppliers were more “commodity like”
- No suppliers posed any threat of forward integration

Storage Industry Score: ++ Great Score
4. Threat of Substitutes: Low.

- Closest substitutes are storage sheds or space at home (garage, attic), which are often times impractical.
- Some substitutes like PODS are not allowed by neighborhoods or are not cost effective.

Storage Industry Score: +

Good Score
5. Barriers to Entry: Low.

- Historically, the Industry’s weak point: In comparison to other real estate sectors, Storage requires relatively low investment, low technology, and creates limited differentiation between competitors.

Storage Industry Score: Weak Score
### Why the Outperformance?
**Self Storage: Five Forces Analysis**

**Five Forces Predicts Strong **Historical** ROI:**

<table>
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<th>Factor</th>
<th>Score</th>
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Five Forces explains why the industry has done so well until now (comparatively high returns and relatively low risk).

BUT...
What does the future hold?
What do the Five Forces Predict?

What are the current trends of the Five Forces?

I. Barriers to Entry:

Improving Trend

Barriers to entry are increasing.

• New self storage zoning is increasingly difficult, making it harder to build new projects.

• Internet is producing economies of scale in marketing which new entrants (with small scale) don’t share.

• Access to capital for new projects is declining as local banks remain over-exposed to the real estate sector.
What do the Five Forces Predict?

What are the current trends of the Five Forces?

2. Bargaining Power of Customers:

**Slightly Negative Trend**

Customers are increasing their bargaining power.

- Internet marketing creates a more comparable “commodity,” increasing a customer’s price awareness, negotiating knowledge and power.

- Excess capacity allows buyers to take advantage of their increased negotiating knowledge.

- Internet marketing increases the geographic range of comparisons. Customers will cross-reference prices with competitors outside of their own geographic regions.
3. Intensity of Competitive Rivalry:

Slightly Negative Trend

Increasing rivalry as customer and supplier power increases.

- Internet marketing scale of REITS makes it tougher for local operators as they compete for the same customers.

- The geographic range (and thus number) of competitors is increasing as a result of Internet marketing.

- Excess Industry capacity and slowing demand growth, combined with high fixed costs and low variable costs, intensifies rivalry.
What do the Five Forces Predict?

What are the current trends of the Five Forces?

4. Bargaining Power of Suppliers:

Very Negative Trend

Increasing sharply as Internet sites become gatekeepers to customers.

- Internet aggregators (think Travelocity for hotels) and marketing companies (think Google) that control internet marketing can leverage power and scale to negotiate profits away from self storage owners. Disastrous if they become buyers vs. suppliers

- Excess industry capacity allows Internet suppliers to take advantage of this negotiating power. The hotel industry is a good case study of how this power erodes profits.
### What do the Five Forces Predict?

What are the current trends of the Five Forces?

#### Five Forces Add Caution to Profitability Trends:

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**Self Storage Industry**
Shepherding the industry forward.
Navigating the Trends
What can individual self storage owners do?

Use strategic positioning and competitive advantages.

• Example: Use regional television ads (like those of Public Storage) to take advantage of local market share and increase total demand in that local market.

• Example: Leverage national scale of REIT networks and marketing to lower supplier power (Google, etc) and increase market share.
Navigating the Trends
What can the Industry do?

Work together through associations to reinforce positive trends and offset negative trends.

• Example: Collect information to focus new construction in areas where demand warrants it.

• Example: Increase demand through shared Industry marketing. E.g. several co-ops already do this (almond, avocado growers, etc).

• Example: Combine purchasing through co-ops to get purchasing scale economies and lower supplier power.
Help prevent overbuilding of storage facilities.

• Example: Develop an industry-wide forecasting model that allows developers to see where and when future capacity is needed.

• Example: Notify banks to use “certified self storage” appraisers who can effectively consider market supply and demand when generating new construction appraisal values. National SSA could offer this certification.
Navigating the Trends

What can Industry associations or co-ops do?

Create a “consumer advocate” Internet site.

• Focus on customer convenience and service, rather than just price.
• Develop a “star” rating system to help customers choose.
• Allow for easy customer feedback and ratings on individual stores.
• Focus store comparison within the consumer’s local area, improving customer service and convenience.
The currents have been at our back, but the winds are shifting. We can maintain industry strength by tacking appropriately.
• Self Storage has performed exceptionally well until now because of strong industry forces.

• BUT, trends within the “Five Forces” are negatively impacting the Industry’s potential future profitability.
  
  • Positive overall structure remains, but less so than in the past.
  
  • Trends are increasing the competitive advantage for large REITs and their networks.
    
  • Smaller competitors can offset these trends through co-ops and Industry affiliations.

• Industry Associations can play an important role in helping offset negative trends in the Five Forces, but this requires intentional and strategic action.
Questions? Ideas? Discussion?

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