2019 Self Storage REIT Outlook: Underweight

- **Fundamentals held up better than expected in 2018.** Growth decelerated on a y/y basis in 2018 (SSRev growth estimated -75bps y/y); however, fundamentals proved more resilient than anticipated. We remain cautious on the group given elevated new supply growth, and expect 2019 to be more challenging than 2018. Current expectations appear to be at the high end of the range, in our view, which could lead to disappointment early in the year.

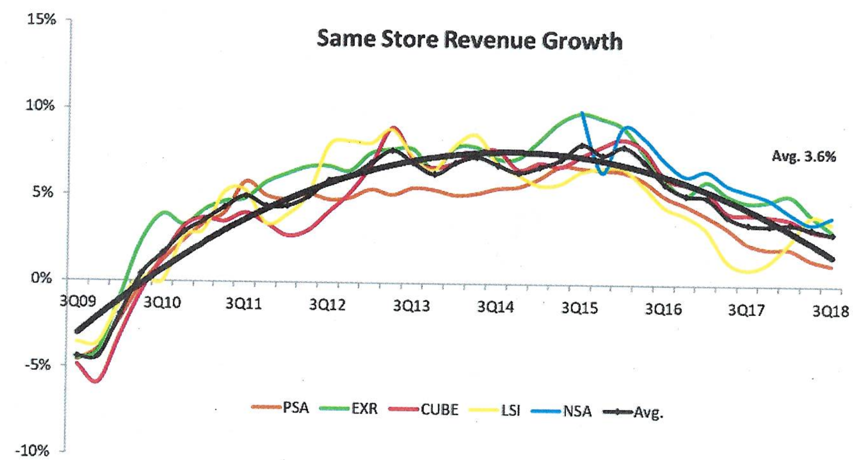
- **Will development activity continue to weigh in 2019?** Data indicates that 2019 deliveries will fall below 2018 levels, but pipelines continue to swell. The 2019 expected delivery pipeline increased from 56 new facilities in July 2018 to 428 new facilities today, and we expect the 2019 pipeline to continue growing throughout the year (e.g., the 2018 pipeline grew from 428 in July 2018 to 571 today).

- **3PM remains a tailwind.** REITs continue to expand third party management programs, aided by growth in new developments (estimated to be 75%+ of all new contracts in 2018). EXR maintains the largest management platform, but through 3Q18, LSI added 60 net new contracts (43% growth); CUBE added 130 net new contracts (29% growth), and EXR added 97 net new contracts (15% growth since year-end 2017). PSA is in the early stages of ramping up its program, which we suspect will gain meaningful momentum in the years ahead.

- **Transaction activity could slow in 2019.** YTD, the self storage REITs acquired (or expect to acquire) $2.3B of property. NSA's $1.325B Simply Self Storage acquisition was the largest transaction of the year; the majority of deals inked by REITs were mainly one-off or smaller portfolio transactions. We expect 2019 to be a busy year, though the absence of a significant transaction could result in lower y/y activity. The REITs continue to enjoy a significant cost of capital advantage over peers (5.1% implied cap rate for the subsector).

- **Slowing growth could lead to multiple contraction; relative valuation seems fair, less compelling on an absolute basis.** The subsector trades at a 7% AFFO multiple premium to the REITs, which compares to the 15-year average of 4%. On an implied cap rate basis, the sector trades at a -90 bsp spread to the REITs, which compares to the 15-year average of -50 bps. See appendix for historical REIT subsector valuation data.

- **How to Play It.** We remain UW the group given concerns around new supply. We are UW PSA given our view that core growth will lag peers in 2019. We reiterate our SW ratings on CUBE, EXR, LSI, and NSA. We would look for a more favorable risk reward opportunity to get more constructive on the group; our longer term view of the subsector remains favorable. We continue to favor OW-rated JCAP for exposure to the self storage development cycle.



New Supply Growth Remains Elevated

	2016	2017	2018E	2019E
New Developments				
Completed	43	305	571	428
		609%	*87%*	*-25%*
Total SF	4,064,989	27,264,918	51,141,656	40,940,579
		571%	*88%*	*-20%*
Total Rentable SF	3,333,279	22,203,870	40,882,290	33,765,876
		566%	*84%*	*-17%*
Conversions				
Completed	41	77	125	0
		88%	*62%*	*-100%*
Total SF	3,743,459	6,908,661	11,501,467	-
		85%	*66%*	*-100%*
Total Rentable SF	3,132,455	5,840,522	9,846,185	-
		86%	*69%*	*-100%*