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| Income Capitalization Approach |

Methodology

The market valuation of the subject property is summarized in this section via the **Direct Capitalization Method** of the Income Approach. In applying the Direct Capitalization Method, two components are necessary in arriving at an estimate of net operating income: potential revenues and projected operating expenses; with the difference resulting in net operating income. Value is then derived by dividing stabilized year's income by a market derived capitalization rate. Therefore, it is important to analyze both income and expenses for the subject property in terms of reasonability and their relative relationship to similar properties in the marketplace.

Potential Gross Rental Income

A review of current subject market trends indicates that typical self-storage or mini-storage unit leases in the subject market area are written on a **gross** rental basis (commonly referred to in the marketplace as “full service” rent). Full service rents indicate that the tenant is only responsible for rent payment, with the landlord responsible for all building operating expenses. Hence, we have anticipated that all future rent for the subject would be payable on this basis.

Comparable Rent Analysis

In order to estimate the current market rent for the subject’s mini-storage units, we conducted a survey of reasonably similar mini-storage facilities within the immediate to expanded market area. In the following section we will analyze the market rent for the subject’s mini-storage units. The results of this survey are summarized on the following pages along with location maps and photographs relating to each comparable property.

Rental Adjustments

Depending on market conditions, free rent, or other incentives are used to attract tenants. Though market conditions have strengthened in the mini-storage sector, free rent concessions are still typical, as the rent survey indicates. These factors have been considered for the following rent comparables which are adjusted to reflect current market terms with an effective rent to the property owner.



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| **Rent Comparable Location Map** |
|  |
|  |

Merge & Insert Rent Comp Photos or Write-ups

Comparable Rent Analysis

The selected projects within the subject’s market area were considered to provide reasonable support and a good basis for estimating the market rent for the subject property.

Merge & Insert Rent Comp Data Analysis Output

Subject Leasing Activity



The subject rent roll summary above indicates there are 78 units in one “M” shaped building. The subject units range from 80 SF to 400 SF with rental rates that range from $140 to $365 per unit. Note the subject provided rent roll (see Addenda) is based on the actual contract rents noted in the chart. The subject units are all exterior entrance units with roll-up door access and a mounted light fixture. Note these are all short-term agreements and the leased fee and the fee simple interest are considered equal.

**8 x 10 Unit –** The subject has 2 of these units with all three renting from $140 per unit. Ownership believes these unit should rent between $140 and $160 per month. Comparable 2 has slightly larger units at the $140 price point and Rent Comp 3 is at $139 for their 7 x 10 units. All things considered the $140 per unit is considered reasonable.

**8 x 14 Unit and 8 x 15 Units –** The subject has 6 (8 x 15) units and one (8 x 14) unit and the rents range from $85 and $165 per month. The asking range for these units ranges from $180 to $190 per month. Rent Comp 2 is most similar to the subject, indicating a market rent of $150 for a 10 x 15 and they should fall below Rent Comp 3 (10 x 10) or $189 per month. The appraiser has applied $150 for these units as the market rent.

**10 x 11 Units and 10-x 12 Units–** The subject has 4 (10 x 11) units and three (10 x 12) units and the rents range from $150 to $160 for these units. The asking range for these units ranges from $170 to $190 per month. Rent Comp 2 is most similar to the subject, indicating a market rent of $140 for a 10 x 11 and $150 for a 10 x 12. The appraiser has applied $150 for these units as the market rent.

**10 x 13 Units and 10 x 15 Units–** The subject has 3 (10 x 13) units and 2 (10 x 15) units and the rents range from $165 to $190 for these units. Rent Comp 2 is most similar to the subject, indicating a market rent of $140 for a 10 x 13 and $150 for a 10 x 15. The appraiser has applied $170 for these units as the market rent.

**10 x 20 Units –** The subject has (27) 10 x 20 units that currently rent between $150 and $240. Note the low end of the range is due to the tenant leasing multiple units and the rate was determined by subtracting the larger units market rate, thus is artificially low. Removing that one space, the range shrinks to $210 to $240 per unit. The asking rates range from $210 to $240 per unit. There are considerable differences in the rental rates from the comparables for these units from $160 to $294 per unit. The appraiser has given less consideration to Rent Comp 2 as the rate appears to drop off for their large units. Rent Comp 3 is considered way above market, and the remaining comparables range from $195 to $233 per month. The appraiser has applied $225 for these units as the market rent.

**10 x 30 Units –** The subject has (24) 10 x 30 units that currently rent between $170 and $270. By removing the low-end space, the range shrinks to $233 to $270 per unit again the low end attributed to multiple unit tenant. The asking rates range from $280 to $300 per unit. There are considerable differences in the rental rates from the comparables for the larger units but the typically rand from $275 to $384. The rate of $270 per unit is considered reasonable for these units.

**11 x 12 Unit –** These units are considered comparable to the 8 x 14 and 8 x15 subject units and $150 per unit has been applied.

**20 x 20 Units –** The subject has (1) 20 x 20 unit that is achieving $365, but ownership is of the opinion the unit could bring in $420 per month. Rent Comp 2 is only getting $250 for their 20 x 20 unit, while Rent Comp 3 is getting $384 for a slightly smaller 12 x 30 unit. Finally rent Comp 5 is getting $300 for a larger 12 x 40 unit. A market rate for this unit appears to be closer to $350, which has been applied.

Mini-Storage Market Rent Conclusions

Based on the preceding analyses, the subject market rents for the mini-storage facility is as follows:



Based on the rent survey data, the subject mini-storage units are considered slightly above market. Which is likely why the subject has more vacancy than most of its competitors. Based on the conclusions for each unit type the subject should average $216 per SF or an overall potential gross rental income of $202,260 annually.

Potential Gross Rental Income

Adding the projected market rental income to reimbursable expenses indicates a total potential gross income for the subject property of **$\_\_\_\_\_\_\_** ($\_\_\_\_\_ per SF NRA).

Vacancy and Credit Loss

This expense category accounts for the time period between tenants, as well as possible prolonged vacancies under slow market conditions. The assignment will reflect the probable vacancy during the economic life of the property.

This expense category accounts for the time period between tenants, as well as possible prolonged vacancies under slow market conditions. The assignment will reflect the probable vacancy during the economic life of the property.

Previously discussed in the "Industry Analysis" section of this report, the 28th Annual Self Storage Almanac 2020 estimates physical vacancy in the Pacific Region at 20.8%, 18.1% nationally.

There is no available market research specific to the self-storage occupancy within the Portland areas. Discussions with Kevin Howard (971.236.9505), owner and manager of 72 Oregon properties indicates an overall vacancy of 17%. However, for his properties in Washington County, overall vacancy is 16%, and his property in Cornelius, the closest property to the subject and used in this Income Approach section as Rent Comp 2, vacancy is currently at 13%. Other properties surveyed in the subject area reported vacancy of 19%, 6%, and 1.2%. The subject would be considered to have a superior location to the two properties posting the high vacancy rates, while having an inferior location compared to Rent Comps 1 and 3, establishing the low vacancy indictors.

The subject currently has 589 units available for rent, excluding the units used by the owner / management. The current physical vacancy is 21.4%. However, it is noted that the subject suffers from superadequacy, overbuilding the property with a second floor on Building D during the final phase of construction. This second level has consistently exhibited high vacancy, with the current vacancy on that level at 52.7%. If the second floor units are not considered, the subject would post a current vacancy of 7.4%. It is also noted that the subject vacancy rate has been steadily decreasing 14.1 basis points from May 2012 to June 2013. This may be attributable to the new professional management that was retained in 2019.

Based on the subject and market data, a stabilized vacancy for the subject’s ground floor units at 7.0% is considered reasonably estimated, and a 50.0% vacancy estimated for the subject’s 2nd floor units.

The mini-storage industry operates on a month-to-month basis, with a turnover average of 10% to 15% per month, according to Kevin Howard, Kevin Howard Real Estate (971.236.9505), a leading participant in the northwest mini-storage market. Due to the high volume of tenants coming and going, there is an expected amount of credit loss. According to industry experts, credit losses are best controlled by having good managers who are able to screen tenants. However, even with good management, facilities can expect to suffer a 2% to 5% credit loss.

The subject’s financial statements do not provide credit loss figures. The property is professionally managed by Cedartree Management Company, managing 13 facilities in Oregon and Washington. The subject is considered to be overbuilt, which will necessitate continued marketing challenges to maintain occupancy. This will exert downward pressure on the economic occupancy of the property as rent concessions will likely be an integral part of maintaining stabilized occupancy. Therefore, credit loss at the upper end of the range at 5% of mini-storage potential gross income, is estimated for the subject on a stabilized basis.

Adding the estimated stabilized vacancy of 7% for the ground level units, 50% for the upper floor units, and the credit loss estimate of 5% results in a **stabilized vacancy and credit loss estimate** of **20.5%** for the subject property, which is applied only to the rental income.

Other Income

This category accounts for all non-rental associated income for the subject property. Other income sources include merchandise sales (boxes, locks, tape, etc.). truck rental, late fees and non-sufficient fund fees. According to the Self Storage Almanac, other income for self storage facilities generally ranges from 2.0% to 5.0% of gross rental income. In terms of the estimated gross rental income of $808,788, that would equate to a range of $16,176 to $40,439. According to the subject's actual financial statements, the subject generated only $4,777 in other income for 2019 and is on track to generate only $2,254 in 2020, based on the other income for January through May. It is noted that other income increases significantly through the summer months. In reference to the Almanac statistics, it is also noted that other income is much more successfully generated within urban facilities.

Based primarily on the subject's actual income, **$\_\_\_\_\_\_\_** is estimated for stabilized **other income**, considered realistic for the subject property.

Effective Gross Income

Based on the preceding, **effective gross income** for the subject property is estimated at **$\_\_\_\_\_\_\_**. This EGI conclusion is well above the subject’s historical EGI at $\_\_\_\_\_\_\_\_\_ in 2019. However, the subject is on track to reach an EGI of $\_\_\_\_\_\_\_ in 2020 based on the financials for January through May, which does not include the summer months, typically a very active season for self storage. Also, the stabilized EGI includes putting back into the available inventory 7 units currently used by the subject owner (approximately $\_\_\_\_\_\_\_\_ annual income).

Projected Operating Expenses

The next step in the Income Capitalization Approach is to estimate the subject's stabilized operating expenses. The market rent conclusion has been based on a full-service rent. The landlord is therefore responsible for real estate taxes, insurance, property management, utilities*,* garbage, maintenance, advertising, office expenses, and reserves for replacement. To estimate expenses applicable to the subject property, the subject’s actual expenses are compared to in-house expense comparables located in the Portland metro area, as well as the expanded market of Western Oregon.

To estimate expenses applicable to the subject property, the subject’s most recent income statement was analyzed. Additional expense information was obtained from in-house expense comparables located in the Portland-Vancouver metro area, as well as market research provided by the 2019 Self Storage Almanac. The mini-storage expense comparables are summarized in the table below.



Real Estate Taxes: Real estate taxes for this analysis are based on the subject’s most recent tax obligation and a projection (3% by law increase) of next year’s rate because the fiscal tax year is more than half over of **$\_\_\_\_\_\_\_\_**.

Insurance: Building insurance for similar mini-storage properties in the Portland metropolitan area generally range from $0.20 to $0.50 per SF. The 2020 amount was $0.117 per SF with no other expense provided and appears unreasonably low for this property type. Therefore, an expense at the lower end of the comparable range of **$0.20 per SF** has been applied.

On-Site Management: The subject’s on-site management expenses total $\_\_\_\_\_\_ in 2019 for the on-site managers on the property. This equates to 7.5% of the reported EGI. However, the expense is on track to increase to 8.1% in 2020, based on the financials from January through May. The industry averages for on-site management generally range from 10% to 20% of EGI, depending on the area. The Self-Storage Almanac uses an expense of 10.88% in their Valuation section. Thus, the subject on-site costs appear to be below market and increasing. A stabilized expense at the low end of the market range of **10.0% of EGI** is considered reasonable and is used in this analysis.

Professional Management Fees: The subject is managed by Cedartree Management Company. The reported professional management of the property in 2019 was 6.0% of the EGI. Professional management firms such as Capital Management, Public Storage, Urban Management, and Kevin Howard are currently charging from 5% to 6% of the effective gross income. Based on the subject and market data, a management expense of **6.0**% **of EGI** is considered applicable.

Utilities / Garage: This category includes the water, sewer, trash, and minimal common area electricity. The subject’s utilities / garage expenses in 2019 were $0.35 per SF NRA. This is well within the market range and is used in this income analysis.

Advertising: The subject reported 2019 advertising costs at $\_\_\_\_ or \_\_\_\_% of EGI. Based on market research, advertising costs for self-storage facilities average 2.5% to 3.0% of EGI. Though the subject has had steady improvement in occupancy over the last year, stronger upward movement may have resulted from a larger advertising budget. Due to the subject's overbuilt status, an upper-end rate of **3.0% of EGI** applied to the estimated stabilized EGI is considered reasonable to maintain stabilized occupancy and is used in this analysis.

Office / Misc. Expenses: Office expenses relates to those items required for the day to day operation of the facility (legal, accounting, postage, supplies, etc.). The subject costs for 2019 equated to $0.30 per SF NRA or 4.4% of the EGI. Based on market research, this is somewhat high, with an expense around 3.0% of EGI applicable for the subject as stabilized. It is noted that the 2020 expenses for January through May 2013 show a slight decrease to 4.1% of the EGI. Based on the market norm, and considering the subject’s decreasing expenditures in this category, a stabilized expense of **3.0% of EGI** considered reasonable for use in this analysis.

Repairs & Maintenance / Security: The subject reported expenses in this category at 2.0% of EGI for 2019. This is at the extreme low end of the market range, generally from 2.0% to 3.5%. Based on the age, quality, and condition of the subject, an expense toward the low end of the range, estimated at **2.5% of EGI**, is used in this analysis.

Reserves for Capital Replacements: This expense is typically not an annual cash outflow, but rather a set-aside for major expenses anticipated in the future for replacement of short-lived items. Park infrastructure is constantly in need of upkeep/investment. The annual expense for reserves for replacement is estimated by determining the replacement cost for the individual items and assuming a realistic economic life. The annual replacement expense is a contribution to the reserve account based on a four-percent sinking fund factor. While expenses for reserves will not be incurred for a number of years, and not every year, it is important that these short-lived components be kept in good condition in order to attract a good tenant base. Reserves for replacement will typically range from below 2.0% to over 3.0% or 4.0% percent of the effective gross income. Considering the subject's age, quality, condition, and features with one elevator and 57.8% of the units heated, an allocation of **2.5% of EGI** is considered reasonable for reserves for replacement items for the subject.

Total Operating Expenses

Based on the preceding, total stabilized operating expenses for the subject property equate to **$\_\_\_\_\_\_\_\_\_** ($\_\_\_\_\_\_ per SF NRA; \_\_\_.\_\_% of EGI)*.* The estimated stabilized operating expenses are considered reasonably supported in this analysis.

Net Operating Income

Based on the preceding, **total stabilized operating expenses** for the subject property of **$\_\_\_\_\_\_\_\_\_\_** ($\_\_\_\_\_\_ per SF NRA; \_\_\_\_.\_\_% of EGI) were considered reasonably supported in this analysis.

Overall Capitalization Rate

Direct Comparison Analysis

The final step of the Income Capitalization Approach is to capitalize the estimated net operating income by an appropriate rate. The capitalization rate is estimated using the market sales method. The overall capitalization rate of each sale is market derived by dividing its net operating income by its cash equivalent sale price. This technique illustrates what purchasers are willing to pay for the net operating income available from competitive investment properties. This method best approximates the decision-making processes of the typical investor.

The primary factors influencing capitalization rates are: 1) The quality and certainty of the net operating income stream; 2) risk factors; 3) physical and locational characteristics of the property; 4) the competitive market position of the property and 5) the potential for future appreciation. The following chart summarizes the data used to estimate the market capitalization rate applicable to the subject property.

Merge cap rate comparables from CARDS and insert into here (example below)

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
| **Comp. No.** | **Property Name Address Location** | **Sale Date** | **Year Built (Renovated)** | **Rentable Area**  **(SF)** | **Cash Equivalent Sales Price** | **Cap Rate** |
| 1 | A-1 U-Store-It 2900 Kauffman Avenue Vancouver, WA | 03/19 (Pending) | 1974 | 23,700 | $3,000,000 | 6.35 % |
| 2 | Hubbard Self Storage 3267 J Street Hubbard, OR | 02/19 | 1993  (2007) | 32,371 | $2,650,000 | 6.50 % |
| 3 | Safegard Mini Storage 1314 N. Schmeer Road Portland, OR | 08/18 | 1980 | 39,110 | $5,400,000 | 6.30 % |
| 4 | Northwest Self Storage 23830 NE Dunberg Loop Newberg, OR | 11/17 | 2016 | 39,300 | $4,950,000 | 6.00 % |
| 5 | Stor-Rite 5515 NE 121st Avenue Vancouver, WA | 08/17 | 2005 | 24,486 | $2,750,000 | 7.68 % |
| 6 | EZ Stor It 615 Molalla Avenue Oregon City, OR | 07/16 | 1975  (2007) | 15,330 | $1,232,180 | 7.76 % |
| 7 | Iron Gate Storage 2900 Northeast 57th Ave. Vancouver, WA | 07/16 | 2001 | 23,999 | $2,300,000 | 5.30 % |

The surveyed capitalization rate sales data indicate a range of capitalization rates from 5.98% to 6.85% (average = 6.25%). The comparables show a relatively small range and are considered to be fair indicators of a market capitalization rate and all of them have been weighed on our conclusion. Based on the subject’s age / condition and unit mix, a capitalization rate toward the middle of the range is considered reasonable.

Cap Rate Conclusion

Based on the preceding, we have concluded a **direct capitalization rate** of **\_\_\_\_\_\_%** as reasonable for use in analyzing the subject property on a stabilized basis.

Concluded Market Value Via The Income Capitalization Approach

To value the subject by Direct Capitalization, the Net Operating Income was divided by the selected overall rate yielding a **stabilized market value** of the fee simple interest in the **subject property**, via the **Income Capitalization Approach** (rounded to the nearest $5,000):

|  |  |
| --- | --- |
|  |  |
| **Concluded Market Value Via the**  **Income Capitalization Approach:** | **$\_\_\_\_\_\_\_\_\_\_\_\_** |

Our analysis of the subject property via the Income Capitalization Approach is presented on the following page.

