



Improving Your Facility's Value In Trying Times

By Nancy Miller

Self-storage owners face uncharted waters in these challenging times. There is a convergence of events that requires owners to make timely and difficult decisions to preserve and enhance the value of their facilities. More and more, owners face maturing loans with few options to turn to in the credit markets. With declines in occupancy, rate competition, and increased expenses, net income has suffered. Owners are sometimes confronted with an economic value of a facility that is less than the loan amount.

This article seeks to provide self-storage owners and operators with insights and strategies to enhance the economic value of their facilities without a large capital outlay through straightforward approaches, offering near-term results. The “end game” is to strengthen the operating and financial performance to be in a better position to extend maturing loans, increase the asset value, and provide quality strategies to enhance value.

Our approach? Ask the experts!

We interviewed experienced experts, including operators, lenders, and appraisers and asked them to share their views and strategies on ways to enhance asset value. Their insights on the following topics are highlighted:

- **The current financial and lending environment**
- **Marketing, revenue enhancement, and expense reduction strategies**
- **Insights on ways to improve property values**
- **High impact/low capital site improvement opportunities**

The “dialogue” at the recent 2010 SSA Fall Show in Las Vegas was consistent with these topics, including loan pressures—both temporary and permanent; declining occupancy with rising operating expenses; the need to re-focus marketing initiatives to attract renters in new and different ways; and site improvements that may enable the greatest gains at the least cost. First, we look at the current environment for the challenges many self-storage operators are facing.

The Current Environment

Loan Pressures: Whether facilities are in lease-up, still under a construction loan, or have a maturing conventional loan or balloon, they are likely to be faced with extending, modifying or finding new financing. In 2010, lenders are following significantly stricter underwriting guidelines, making it difficult for operators with slow lease-up or declining occupancy to meet lender criteria. If traditional financing is not possible, owners will be forced to consider less desirable options: infuse equity, find financial partners, sell, or possibly return the asset to the bank with a deed in lieu of foreclosure.

Declining Occupancy: Most owners have reported physical and economic occupancy declines in the past two years of 5 to 10 percent. Some have noted faster recapture gains in 2010 over 2009. However, these gains are often coming from rent concessions, which further impair net income.

Operating Expenses on the Rise: "Many costs continue to rise," says Tom Nicholson of AAAA Self Storage. "Modest occupancy improvements and rent concessions do not significantly provide relief in spreading expenses. Approximately half of these expenses are fixed." So, the challenge to find areas of cost reduction is great.

Nicholson, who was a presenter at the 2010 Fall Self-storage Association Conference, indicated that his company's portfolio experienced expense increases over the last eight years in the areas of salary (up 84 percent), technology (up 784 percent), and marketing (up 512 percent). To counter operating expense increases, operators are beginning to look at alternative strategies to reduce costs and better utilize current infrastructure.

Re-Focus Marketing Initiatives: In light of rising expenses, operators must "re-focus" and identify ways to increase profitability. These, in turn will translate to increased value of a facility. Several strategies are relevant to the current environment, including re-engineering the role of the site manager from "caretaker" to marketer, expanding marketing platforms to include more emphasis on the Internet, studying the competition, expanding retail

sales initiatives, and adjusting prices and unit mix.

Site Improvements on a Budget:

To increase profitability with the limited funds, operators should determine where they get the greatest "bang for their buck" when investing in site improvements. "The Spring 2010 Self-storage Pulse Survey" article published in the September issue of *Mini-Storage Messenger*, I highlighted the following contributors to higher occupancy: friendly staff, location, curb appeal, referrals, signage, and walk-in traffic. Stuart Wade of AAAA Self-storage, in his presentation at the Fall SSA show, recommended simple strategies such as painting, new gutters, and reconditioning doors as well as other strategies that require minimal capital and have a significant impact on curb appeal.

These topics will be covered in greater detail as we hear from the experts.

Lender Perspectives in the Current Self-Storage Environment

When the clock is ticking on notes, balloons, and mortgages, lenders should be the first place owners turn. The average refinancing transaction now takes four to six months in today's lending environment. Experts recommend that owners contact lenders well in advance – 9 months is not too soon!

"There is no convincing lenders today on proforma numbers," says Neal Gussis, a principal in The BSC Group, a Chicago based commercial brokerage and advisory group. Gussis shares his experience in assisting owners with re-financing of self-storage facilities. "Good looks don't help... Trailing 12 months' cash flow is it." He goes on to predict that lenders will continue to scrutinize non-institutional loans and that 90 percent of the equity will not return to the peak levels we saw in 2007 for a sustained period of time. When asked how long that timeframe is, he responds, "A good five years."

Another lender, Sarasota based mortgage banker, Brad Cox, CCIM and senior vice president of Thomas Wood and Company, forecasts 641 CMBS loan maturing through 2012. The average loan amount is \$4.2 million, equating to roughly \$2.7 billion in maturing loans. Cox adds

Five Important Strategies to Consider

Neal Gussis offers these strategies to deal with potentially troubled assets with balloons on performing loans or notes coming due:

1. Pay down loans faster to create a cushion with accelerated principal reduction. This can increase equity and reduce leverage and the need for additional loan pay-down as a condition of refinancing.
2. Prior to approaching the lender, pull out non-recurring expenses or hidden write-offs. While they are good for reducing tax liability, they also reduce the net income, which detracts from the loan to value ratios.
3. If the mortgage balance is higher than the property valuation or the underwriting guidelines are not met, the lender will request that the borrower reduce the loan balance as a condition of re-financing. Several scenarios are possible:
 - If viable, pay down the principal to meet the underwriting guidelines if the assets are available.
 - If assets are not available, look for an equity partner to infuse cash and reduce the principal balance on the loan.
 - Work with the lender to extend, modify, or possibly write off a portion of the note. If the loan has been consistently paid and the cash flow is covering current expenses and a part or all of the debt service, the lender may consider reducing the balance. However, they will require the borrower to contribute equity as well.
4. Identify healthy assets in your portfolio. Debt can more readily be placed on them. The borrowed dollars can be deployed to reduce the loan to value (LTV) on any troubled assets, balloons, or notes coming due.
5. Most times, you have one shot at negotiating a deal. Put yourself in the best position possible and consider hiring a third party consultant to assist in a work out strategy.

that this is across all property types, but all will be vying for financing. He anticipates financing to be available but occupancy will need to be at least 75 percent for life company (non-recourse) loans. He also sees alternative financing in the form of one- to three-year bridge loans.

When asked about further insights and recommendations for operators to improve valuation of their facilities in the short term, Cox responds: "Be on top of management. Make sure rents are competitive and go beyond the call of duty when it comes to service. The property must be in great condition, clean, and be overly safe at all times."

Marketing, Revenues Enhancement And Expense Reduction Strategies

Self-storage marketing expert Carol Shipley, vice president of third-party management with U-Stor-It Trust, knows what it takes to market and to enhance revenues. "Be nimble. Know what the competition is doing," says Shipley, who recently merged her managed portfolio of approximately 85 facilities with U-Store-It (USI).

The role of the Internet: Shipley sees the Internet as more important than ever as a marketing vehicle. She reports that for USI, traffic from the Internet to facilities is fast approaching the same level as that from drive-by traffic, which is at nearly 50 percent, while customers from *Yellow Pages* and other sources continue to be in the single digits. She says related strategies to capitalize on the Internet include bidding strategies for Web positioning, building links with other compatible sites, and using "intelligent re-targeting" that bring shoppers/prospects to compatible sites.

Rate management strategies: Shipley stresses the importance of training managers on using discounts wisely and offering full-price rentals for customers who walk in off the street with a truck full of furniture. "Don't be afraid to raise existing tenant rates," she says. "Most companies are able to push through moderate rate increases even in these tough economic times."

Relationships are key: Success is often measured by the quality of relationships between owners, managers, and customers. Shipley asserts that self-storage is a relationship business, and that those who

don't understand this are not going to be as successful. She advocates manager involvement in the community, both onsite, in schools, with the local chamber while keeping the facility as "top of the mind."

Expense reduction strategies: USI reduced same-store expenses for the second quarter of 2009 by 4.4 percent, and increased same-store net operating income by 2.1 percent for the same period. How was this accomplished? "We decreased advertising costs substantially, primarily by reducing our *Yellow Pages* presence," Shipley explains. "Other strategies of rate management, training, relationship building, and creating alternative sources of revenue made, and will make, a big difference."

Future opportunities and challenges: To enhance value and profitability, Shipley is adamant on the need for operators to change the way they do business and the perception of self-storage. She believes customers are "more discerning" and will look for self-storage operators to differentiate themselves in some fashion.

Enhancing The Value Of A Facility

Anne Ballard, president of Universal Management Company, can also share an expert perspective on enhancing a facility's value. Ballard is a noted industry marketing expert and who advocates proactive marketing, results tracking, and utilizing the Internet for increasing exposure and rentals.

Ballard's insights to enhance the value of a facility through proactive revenue enhancement include:

1. Convert marketing traffic into sales—missing an opportunity is costly. Don't let the prospect leave without renting! Come right out and ask for the business: "What will it take for you to become my customer today?" You might be surprised by how easy it is. Most people want to know you really want their business ... and they appreciate being asked. Also, track where the business is coming from so you know where to spend your advertising dollars.

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2. Strategically use the Internet, including Facebook, Twitter, and tools such as Constant Contact to expand your database and keep in touch with suspects, prospects, and customers.
3. Increase cash flow by having managers call 15 to 30 existing customers each month to promote discounts with short-term, prepaid rentals.
4. Review rates each month and adjust them on a scheduled basis for all renters, usually mid-month. Each customer should receive at least one rent increase per year. Operators are not doing themselves any favors by putting off rent increases because of fear of move-outs. If they have been well served, customers don't move out due to moderate rate increases each year. Find the opportunities to raise street rates when a particular size is approaching 90 percent or has only a few vacant units.
5. Use event marketing and networking to create a community presence, and place your brand as "top of the mind." Generate more "door turns" and get these visitors to become part of your marketing army.
6. Empower and train managers as your best calling card to promote repeat rentals, referrals, and cross-selling.
7. Establish personal marketing goals for managers for each month and track the results of their personal selling efforts.

Other revenue enhancement strategies many operators are adopting with good results include:

- Automatically increase rates for the most popular unit sizes when the facility has less than 20 percent remaining of that size.
- Increase street rates when the facility is 90 percent occupied in a specific unit size.
- Ensure a price differential for walk-ins versus call-ins.
- Determine the competitors' unit mixes and adjust your rates so yours are higher where they are likely to be sold out.
- Assess your unit mix and determine if there are modifications that can be made

PGP CAP Rate Guidelines For Self-Storage Facilities

Characteristics

- Good quality/Good location
- Average quality/Average location
- Fair quality /Poor or saturated locations

CAP Rates

- 8.0% - 8.5%
- 8.75% - 9.5%
- 10% - 12%

to create more unit sizes that are in higher demand.

Appraiser Perspectives On Enhancing Facility Value

Prior to the current economic environment, self-storage appraisers had a much easier job. They used a variety of appraisal approaches: sales comps, replacement cost or income/CAP rate approach. It is another day and time! Today, due to lender pressures, appraisers look at economic performance measured by CAP rates or the ratio of net income to purchase price before debt service (Net Income/Price = CAP rate).

Cash Flow Enhancement Strategies

- Consider creating smaller units that command a higher rate per square foot. (Example: Offer 4-by-4s or 5-by-5s in college markets.)
- Establish bonus plans for managers with target goals for retail sales, truck rentals, insurance, storage rentals, customer retention, referrals, and customer feedback. (Example: Insurance up-selling. Targeting 50 percent of renters in a facility with 500 units provides an additional \$13,000+ in income.)
- Limit rent concessions to renters who have the highest likelihood of long-term stays of six months. Don't give away a free month to a short-term renter! (Look at the long-term impact of rent concessions on valuation. Giving away \$10,000 in concessions in a year is the same as reducing the value of the facility by \$100,000.)
- Evaluate and expand your RV/boat strategies to increase incremental revenues.
- Re-evaluate advertising expenditures and consider reductions of traditional (*Yellow Pages*) advertising.

According to PGP Valuation Inc., a subsidiary of Colliers International (CMN), CAP rates for self-storage facilities have increased by 100 to 150 basis points over the last two years, with typical CAP rates ranging from 8 percent to 10 percent based on trailing 12 months of net income, not proforma income. However, PGP is seeing a slight decline in CAP rates over the last six months. Transactions below an 8.0 percent CAP rate are hard to find (and hard to finance) in this economy. PGP identifies the following current guidelines for CAP rates:

Finding comps is a challenge for appraisers. Since storage sales have been significantly lower in volume over the last few years, appraisers consider more accurate comps to be based upon recent sales, regardless of the market area.

Jeffrey Shouse, a leading self-storage appraiser and self-storage director for PGP Valuation, has done extensive research on ways owners can increase a facility's value. Some of the highlights he shares include:

1. Concessions: Be cautious not to advertise blanket specials. Strategically target units that have traditionally lower occupancy.
2. Find "hidden" revenue opportunities: Ideas include cell towers, billboard leasing, truck rentals, and soon-to-be more popular solar panels on roofs of units as income and a source of free electricity.
3. Manage first impressions: The facility should look clean and trash free, the paint should be fresh, units should be clean, and landscaping and curb appeal should be pleasing.
4. Happy managers make happy tenants: Encourage managers to realize that they are the ambassadors of their properties and can be pivotal in attracting and retaining tenants.

5. **Promote security:** Tenants are attracted to facilities that are secure and well lit. Make sure you don't lose a renter due to easy modifications.

Atlanta based self-storage appraiser Shelby Edwards has appraised facilities in 27 states. He sees several areas that contribute to improved asset valuation.

- **Location** – better locations generally mean less expenditure for advertising.

"One of the first things I look at in valuing a property is the annual advertising expense. If a property has inferior traffic exposure to most of the other competition, are they spending the money in ways that directly benefit the property such as a billboard, that could increase exposure to vehicle traffic," says Edwards. "The days of simply taking out a *Yellow Pages* ad are over, and an increasing amount of advertising dollars are being diverted to Internet marketing."

- **Physical attributes of the property** – nicer and newer always appeals to customers, investors, and appraisers.

"Maybe it's the sense of security for one's goods that a higher quality facility offers," Edwards says. For investors, he says that "newer properties may mean higher resale, lower maintenance costs, and higher occupancy levels over the long-term." He definitely takes this into consideration when completing an appraisal.

- **Older Facilities**

Regarding older facilities, Edwards says owners of older second- and third-generation properties may be able to improve performance by improving the appearance. "New paint, fencing, driveways, and/or renovation to the office can make many older properties look almost new," he says.

- **Unstabilized Facilities**

Regarding newly constructed or unstabilized facilities, Edwards says, "A high vacancy doesn't always mean a property is unstabilized, and a careful study of the market as well as the leasing history will help an appraiser to determine this."

This is an interesting perspective since one has to discern whether a market is overbuilt, or if the local market is not inter-

Site Improvements Checklist

<ol style="list-style-type: none">1. Curb appeal: Make sure the road exterior is neat, stays mowed, and that your signage is visible and not hidden by trees that need trimming.2. Landscaping: Add to the curb appeal by placing low maintenance, attractive shrubs and limited grass in areas that are visible during the first impression. This could include large, potted plants at the entry to the office and a few plants in the office.3. Neatness: Make sure the grounds—including the area by your dumpster—are picked up daily with no debris. This should also hold true of interior hallways.4. Odors: Nothing will turn tenants off quicker than musty odors in hallways or near dumpsters. This should be monitored daily.5. Roadways and driveways: Correct or fill any cracking pavement throughout the facility. This speaks to "deferred maintenance" and lack of care for an easy fix.6. Lighting and light bulbs: Make sure bulbs and motion sensors are working throughout. Ask tenants to report any bulbs that are not working or missing.7. Consider 24-hour access: If not offered now, tenants like 24-hour access. Poll your tenants and see what they say.8. Painting and gutters: Examine the exterior paint of the buildings and consider touch-up or repainting. This especially true of faded doors. Also,	<p>periodically pressure wash and make sure gutters are connected and look to be in good shape.</p> <ol style="list-style-type: none">9. Vehicles: Make sure that non-working vehicles that are stored are not "eye sores" (remember first impressions). If they have to be there, put them out of the way.10. Security: Does your renter feel safe when arriving? If not, this needs to be a priority. Check your fencing, add cameras, etc. Let folks know you are monitoring.11. Office/retail updates: Make your office is a welcome place to visit. Consider a "Welcome – Come In" sign. Install a granite counter top remnant to update your front counter. For next to nothing, you have added a touch of elegance. Make sure the flooring is clean. Consider re-tiling. Add a water cooler and coffee maker for renters. Consider placing a round table with four chairs in the retail area. Make the environment feel friendly and conversational. Consider offering WI-FI to renters on the run. Organize your retail area so all products are visible and neatly displayed. Consider creating a photo wall with photos provided by renters of community events such as ball games, family events, etc12. Music: Consider locating speakers in hallways and in the office and pipe in XM Radio or your favorite artists. This is a great way to make renters feel comfortable on the interior instead of wondering what lurks behind other locked units!
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ested in the price differential of climate control or the inconvenience of a multi-story facility.

Site Improvement Strategies On A Budget

So how do we put this all together and improve the site to enhance value on a budget? As noted above, first impressions are important to renters, appraisers, and ultimately, the lender. Consider the items on this checklist to "spruce up" your facility with low cost and high impact.

Onward to enhanced value! Take time to consider some of the strategies and

opportunities presented by these experts. Our mission has been to provide owners with cost effective strategies to enhance the value of their facilities in light of the current challenges we are facing. The experts welcome your contact for further questions. 

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