

## THIRD-PARTY PROPERTY MANAGEMENT

# A Competitive Edge For Smaller Companies

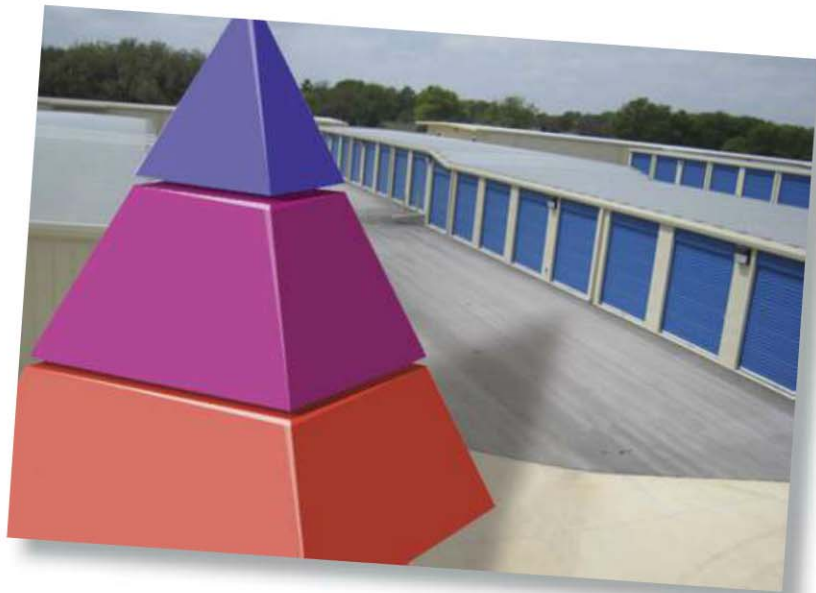
By Peter Ingersoll

A kind of consolidation has occurred in the self-storage industry—a broad movement towards the use of third-party managers. At first blush, this trend seemed to be a move on the part of REITs and large operators to supplement income during 2009 and 2010 when occupancies and rents were falling. Now, upon closer inspection, there is clearly an element of organic demand coming from smaller operators. This demand stems from the fundamental economics of the self-storage business itself.

### Economies Of Scale

Self-storage is perhaps the only real estate asset class that benefits from economies of scale. In contrast, as owners and managers of apartments grow their portfolios, their expense ratios stay relatively constant—for every 1000 units or so, they must hire the same number of managers, accountants and maintenance personnel to operate the properties, so the expense ratios generally remain constant regardless of portfolio size. The same is true with other property types such as office, retail and hotels. Not so with self-storage.

As portfolio size grows for self-storage, significant operating efficiencies result. Larger operators enjoy lower costs, wider gross margins, better market exposure and more success at attracting new customers. According to Devin Huber, a partner with BSC Group and an experienced mortgage originator in the self-storage sector, “the market is becoming more and more bifurcated with the Internet ever more prevalent as an impressive tool to find new cus-



tomers. Larger operators have a significant leg up with their economies of scale and their ability to run their own call centers and Internet marketing campaigns.”

The simplest example of these economies of scale is the ability of larger operators to purchase goods and services at lower costs. These savings fall directly to the bottom line for the property owner, provided or course, that the third party management company does not keep

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this savings for itself. Allocation of valuable marketing dollars is another issue that is part and parcel to high operating expenses. “Often we find that operating costs are out of control,” says Noah Springer with Extra Space. “Yellow Pages advertising, Internet dollars—particularly pay-per-click and ad-words—are being spent without any rhyme or reason, and without tracking results. This is simply throwing money away!” On closer examination, different operating efficiencies of larger portfolios begin to emerge other than a fatter gross margin.

In today’s wired, mobile world, static Web sites no longer attract new customers and are being increasingly overshadowed by interactive Web sites that are integrated into comprehensive social media campaigns. So, the ability to have an expert on staff to navigate the mind-numbing complexity of on-line marketing and social media is significant. Although, each individual task related to on-line marketing is not particularly difficult, the problem arises when hundreds of

individual tasks must be coordinated with an equal number of potential vendors and then integrated into an approach that works seamlessly with the operator's Web site, search engine optimization (SEO), pay per click initiatives, a reservation system and/or call center. No single operator can afford to hire this expertise or has the time to do it himself, let alone accurately track the results of these programs. According to Carol Shipley, vice president of Third Party Management with U-Store-It, "Smaller operators are having trouble as the Internet becomes more important for sourcing new customers. They don't have the resources for software programming, data mining or staffing to handle the complexity of social media."

### Changing Business Models

It may take a shift in deep, commonly-held beliefs for a smaller owner to accept the notion that third-party property managers may be better equipped to compete in today's market. Only a few years ago, panelists at national and state association gatherings extolled the virtues of an independent on-site manager. The manager was the company's primary source of perspective on local competitive advantage. This management model had on-site managers answering the phone, pricing and/or discounting units, signing the lease and renting the units, and keeping the grounds clean and well maintained. But the model has since been demonstrated to be more romantic than practical, and it is no longer being taught at management education events, though belief in it lingers on.

According to Skip Elephante, whose company Platinum Storage Group recently took over the management of 61 EBS locations, "many, many small operators think that if they have a good manager, that's all they need and hope that it all works out, but economies of scale can allow for professional Web management and SEO integration with specific marketing initiatives, whether it is a pricing discount or a specific promotion. More importantly, it allows staff to diagnose why units are or are not renting and respond faster. Two or three additional rentals per month at each site make a huge difference for any owner."

Critical mass does not end with Internet-related marketing; it impacts staffing and employee productivity. According to Steve Mirabito, president of StoragePro, who focuses much of his time on recruiting, training and inspiring his employees, "People would rather work in Costco®

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than in self-storage, even though the salary and benefits of being a self-storage manager are much better. The reason for this is that a single manager at a single store is isolated. People need camaraderie; they want to learn from their peers and share best practices. Small operators have no objective measure of performance because they don't have enough employees. Using an experienced self-storage property manager removes subjectivity and gives employees the camaraderie they are looking for." A manager's ability to learn from other managers who are struggling with the same, day-in-day-out issues also creates a culture for the self-initiated to improve and succeed; it creates an environment where employees can be recognized for superior results; and it creates healthy competition to be the best among peers.

Is property management a magic bullet? Clearly the answer is "No!" Change takes time, effort and a clear commitment to a well thought out, strategic plan. Steve Mirabito comments that, "Often clients have unreasonably high expectations about how quickly results will appear, or how much the occupancy and income will increase. This is particularly true of owners facing a loan maturity. They need results quickly, but it takes time to get a property on the path of growth." Just as owners should give themselves plenty of time in preparing for a refinancing, so too should they plan a conversion to a third-party property manager well in advance of a loan maturity or other financing need. How

much does a property manager really help in securing financing in this capital starved market? Are small operators penalized for a lack of Internet marketing wizardry and their own call center?

According to Jeff Ganaden, a self-storage specialist with US Bank, the bank "won't discount the income simply because a small operator is making an application. It depends on the dynamics of the market and the surrounding competition. In some markets the owner may not need sophistication to be competitive. However, for comparable properties in comparable markets, the marketing tools, management depth and systems sophistication certainly help." In the end, lenders are looking for historical net operating income (NOI), to project future rent growth and occupancy. Whether a budget is prepared by a third-party manager or a small owner probably will not be a factor that influences underwriting. For property management to work effectively, timing is important. A switch to a property manager a few months before a loan application probably will not move the needle enough to make a difference.

### Third-Party Arbiters ...

However, there are instances where third-party property management is mandated. According to Devin Huber, a partner with BSC Group, "If a property is underperforming and the owner is in discussion with the bank to modify the loan terms, banks are increasingly asking for professional management to step in as a condition of the loan modification. This also happens when an outside equity investor is involved in a property recapitalization or when a buyer has limited operating experience. The lender or equity partner wants the financial controls in place to insure smooth operations."

### ... And Data Analysts

Economies of scale show up in other ways as well. Larger operators have the ability to test management and marketing concepts before rolling out the ideas company-wide. Extra Space has been very open and transparent about the results of their ongoing campaign to test multiple ideas against a large pool of customers. Both their research findings and their portfolio performance are

difficult to argue with. Skip Elephante is also a strong proponent of testing concepts and monitoring the results. "We have a central dash board for management control and don't have to wait until month end to see results. With the on-line tools we and our owners can respond quickly to management needs and market trends. This helps boost morale at the site, everyone gets excited when something works; everyone is relieved when we can correct a mistake quickly and not waste time and resources."

Confidence in results that can be measured extends beyond the on-site manager and into the owner's office. Most of us glaze over and fall asleep when discussing statistics, but it is intuitive that with the limited pool of customers available, small operators often make decisions based more on anecdotal evidence than on measurable trends and results. Conversely, armed with facts and an understanding culled from a broad base of customers, owners can make better decisions and allocate their investment dollars more effectively, which creates greater diversity and safety. The flip side of this equation is hesitation. Noah Springer of Extra Space has seen first-hand that owners can sometimes hurt themselves without knowing it. "Because marketing results and the reasons for turnover haven't been tracked accurately," he says, "owners are often hesitant to raise rates." While price is an important competitive tool, if it is the only tool an owner has in his or her tool bag, perhaps it is time to consider a property manager who has the Internet savvy and marketing machinery to put occupancy and rent growth back into the income projections.

What does the future look like for small operators? Prospects are good. "This industry has long been a hot bed for entrepreneurs. Small operators will do what they have always done best: find, acquire and build properties in their local markets," says Carol Shipley. "The smart ones will leave the management to larger groups that have the scale and focus on their strength, opportunities in their local market." I could not agree more. One of the best features of self-storage has been and continues to be its fiercely

independent, opinionated and proactive small owners. In my view, turning over the management reins frees up oceans of time, and creates more opportunity than any apparent loss of control. This is good for small owners, good for customers and good for the industry. 

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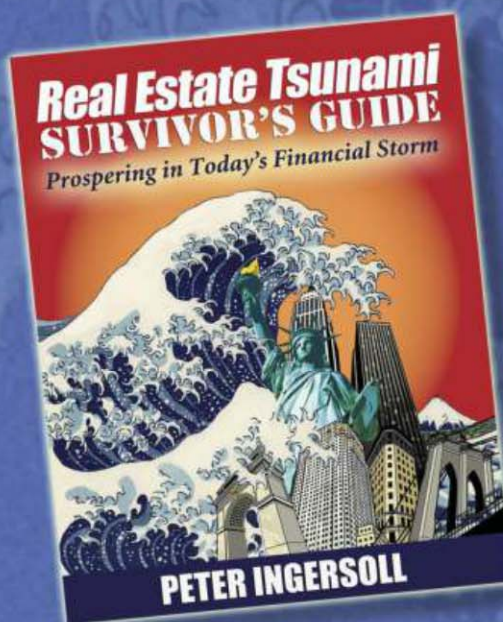
*Tsunami Survivor's Guide* and a registered investment advisor who works exclusively with buyers and accredited commercial real estate investors. He



has over 25 years of experience as a builder, developer, trust officer, investment banker and commercial broker, and serves as the vice chairman of the California Self Storage Association.

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by Peter Ingersoll



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