

Eyeing Development? Be Market-Savvy and Realistic

Bring plenty of guts, money and an appetite for risk to the table, too.

By Mark Wright

Too bad *The Audacity of Hope* is already taken as a book title. It would make a great motto for self storage development these days.

Planting a storage facility on virgin turf today requires not only audacity and hope. It also takes a keen eye for consumer demand, extra-solid financing and a huge tolerance for risk. Wishful thinkers and property flippers beware: This is a time for cold, hard reality.

“If you have the courage to start a new development in this environment, it’s a lot more attractive,” says Tim Hobin, vice president of development at Santa Monica, California-based William Warren Associates. “Land’s a lot less in demand. Not a lot of other real estate types are chasing building for conversions and redevelopment opportunities. Plus, construction costs have come down, or at least stabilized, in some areas.”

That’s the sunny side of the story. Few people, however, are taking on the risk, says Hobin, partially because of the financing.

“No one knows in four or five years what the permanent debt market is going to look like,” he observes. “Today, the permanent loan market is very expensive. The lenders are

looking at the cost of taking out that loan, and the loan proceeds are a lot less than they used to be.”

Craig Olson, president of Los Angeles, California-based A-American Self Storage Management Co., Inc., wants this blunt fact about today’s environment out on the table in black and white: Self storage is generally overbuilt, so new development usually makes no sense.

What if your inner child, your secret desire to live dangerously, or your very DNA demands that you develop? “Find a market where there is little storage and housing is healthy,” advises Olson. “Go to areas where you have growth. The self storage business feeds off of rooftops.” A place like Omaha, Nebraska, might be a possibility, he says.

In the same way you wouldn’t dive into a swimming hole if you’re not sure how deep it is or where the rocks are, you want to know what you’re getting into before jumping into a new building project. First and foremost: Is the demand really there? *Really?* And who else shares the marketplace? How might competitors’ plans and other factors affect your facility in a year, five years, ten years?

“The most effective operators focus on regional markets,” observes Larry Nora of Chicago Capital Funds LLC. They

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build a critical mass in specific submarkets around the country.”

His firm is focusing close to home right now, he says. “I sold my portfolio in July 2007, and haven’t built anything for the last two years. We’re looking to do one or two properties a year in the Chicago area, with an infill location where demand is reasonably strong. Prices of land, buildings, steel and concrete are all reduced, so that made it more appealing to start development at a slow and cautious pace. We’re not setting the world on fire. We don’t want to get ahead of ourselves or the economy.”

One of the challenges with self storage development, says Olson, is its singular use. He notes that a light retail development can shift from one business to another fairly easily—but that’s not true of self storage.

“As an asset class, we’re so different from everything else,” he says. “If there are seven florists in an area that will only support five, that means two will go out of business—likely the ones managed worst or in the worst location. If the florist goes out of business, you can just put another retail business in there. But what will you do with a property built for only one specific purpose? You have to go through considerable costs and approvals to turn self storage into buildings people can occupy.”

With the self storage market, says Olson, “the oldest and weakest (properties) could go. If you had converted a building or a warehouse, maybe you could convert it back if the self storage facility fails.” Worst-case, he says: “We might see some things getting bulldozed.”

The prospect of bulldozers rumbling over excess development might seem so radical as to be impossible, but Olson sites a residential development near Victorville, California, where the unthinkable happened after the bank took over a bunch of new but unoccupied homes. (Since reading is much harder while shivering under your desk, we won’t dwell on this possibility here.)

The real take-away from such cautionary tales is not, “Be afraid...be very afraid,” but rather, “Be smart...be very smart.”

“I think you can be spooked by the headlines,” observes Hobin, but since there is no new job growth and the industry needs people moving and relocating to create storage demand, the best approach might be to take advantage of the pullback.

“When job growth returns, you’ll see occupancies rise,” predicts Hobin. “A period of little construction will bode well a few years down the road, so everyone will be operating at capacity. Then you can see construction take off again. When there’s a lack of new supply in the market, traditionally you get a nice spurt when it recovers.” ❖

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