Mixing It Up

Pairing storage with retail can ease permitting, increase revenue and support the community.

By Laura Williams-Tracy

On the last remaining developable tract of land in the Southern California community of Ladera Ranch, self storage is the new neighbor on the block.

Storage—which isn’t often looked upon fondly by permitting authorities—has found a place in the master-planned residential area, in part, because it’s bringing along an attractive partner. SmartStop Self Storage will open a 230-unit storage facility this summer alongside an office space and a community sports center that offers eight highly desired basketball and volleyball courts for local club and school teams.

“I’d like to say this is the future model for storage, but really this was about finding the highest and best use for this property,” said developer and Strategic Storage Trust CEO Michael Schwartz, who is developing the mixed-use project in the community where he lives. “I do think there are situations where you can mix storage with other asset classes.”

Schwartz says he believes he could have gotten single-use zoning approval for storage at the 3.5 acre site that he’s owned for five years, but he didn’t need another 100,000 square feet of storage in the area. What he needed was office space for his growing business, even after selling SmartStop for $1.4 billion to Extra Space Storage in 2015.

The community needed and wanted the sports facility, and combining 40,000 square feet of storage, 16,000 feet of office and the almost 60,000 square foot gym helped spread costs and make the $32.6 million project financially feasible.

“By doing the mixed-use, it creates an environment that’s a win-win for all three,” Schwartz said.

“It’s a plum project,” said Chris Sonne, executive vice president of CBRE Group Inc., in charge of the self storage valuation group. “They get a terrific storage facility in a market where there are no places left to build. The community loves it because sports facilities can be so hard to find.”

Finding Partners in Retail

Mixed-use projects have been the darlings of planning commissions nationwide for more than a decade, but they are only beginning to make inroads in the self storage industry. In 2008, Seattle architect Stephen Bourne released a publication for the SSA titled, Self Storage in Mixed-Use Development, an Analysis of Case Studies.

Bourne said the case studies revealed a number of advantages for storage developers considering moving beyond single use. But shortly after publication, storage development—and pretty much all commercial development—came to a screeching halt in the recession. With development returning and strong, mixed-use storage is getting a second look.

“It can be an aid to getting your project approved in zoning,” said Bourne, who designs storage projects in the Pacific Northwest, including Washington, British Columbia, Oregon and California. “Sometimes planners don’t like storage because it doesn’t generate much sales tax or employment numbers. Adding a retail component augments the use and mitigates that issue.”

Logically it would seem that storage might work best paired with a residential community, such as alongside apartments. But developers and industry watchers say few projects of that model have come to fruition. At its core, storage is a retail business, and it works best when paired with complimentary retailers.

“Residential and storage is done on the rare occasion, but mixing residential and industrial zoning is so hard to do,” Sonne says. “The most common mixed use includes retail.”

Retail that supports an office environment is especially complimentary, Bourne said. For example, an H&R Block tax office, a FedEx office store, dry cleaners, hair dressers and an equipment rental business seem to thrive near storage. In most developments, retail is not the prime driver of the development and retail income can’t compete with more profitable storage rental income.

Marc Boorstein, a partner with MJ Partners Real Estate Services, said he’s currently evaluating more proposals for mixed-use storage projects throughout the country than at any other point in his 30 years in the industry.

“It’s definitely getting to be much more of a consideration for private developers, entrepreneurial developers and private equity companies,” Boorstein said. “I’m now
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looking at 12 proposals nationwide. I don’t know how many will go through, but I like a lot of them. Mixed-use has never been a big part of the storage industry, but I’m surprised because it works well.”

Storage benefits from traffic generation when it’s paired with retail, Boorstein said. MJ Partners is selling a property on behalf of Timco Realty in a suburb of Philadelphia that’s a converted Kmart store.

“There’s definitely interest on these deals when they are done well,” Boorstein said. “I’ve seen storage paired with a small Walmart Express that did very well.”

Be Ready for Complications

Developing mixed-use projects alongside storage is more complicated than single-use developments, Boorstein said. Loading docks must be available to both storage customers and retail tenants but not necessarily at the same time. Traffic flow in the center is also a consideration. But storage often works well in centers with retail because storage doesn’t require as much parking.

Some storage owners are reluctant to welcome other uses to their projects. Large REITs see mixed use as a departure from their core business.

“We don’t have a large appetite for mixed-use projects,” said Jeff Norman, senior director of investor relations and corporate communications for Extra Space Storage. “Occasionally, we will add some retail/commercial as required to obtain permitting, but generally we would prefer to just have it purely storage.”

A spokesman for CubeSmart says it does little in the realm of pursuing mixed-use projects.

“Retail with self storage can be harder to sell, not because people don’t like it but because they are storage operators and they don’t know how to operate a retail center,” said Sonne of CBRE.
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Likewise, mixed-use projects that include storage are much harder to appraise the value of than a stand-alone storage facility.

Schwartz said he encountered challenges along the way with his Ladera Ranch project.

“It was very difficult doing mixed use,” Schwartz said. “We know what the value of an office is and the value of storage, but it was hard to determine the value of the sport center when talking with lenders. This project was not easy in any way, shape or form, but we are excited about it.”

One way around the reluctance of storage owners to be landlords to retail tenants is to develop the project as a condominium—a legal term that defines a portion of ownership in real property. Under a condominium arrangement, the storage operators might own the storage facility and a big box retailer might own the portion of the development that includes the store. That’s the way Schwartz’s Ladera Ranch project is assembled.

There may be more opportunities for storage to get closer to retail developments as big retailers such as Sears, JCPenney or Office Depot reduce store count and vacate shopping centers, leaving space for other businesses.

Mixed-use complicates project development, but the dynamic between storage and retail can be a combination that makes the project work.

“There’s enough revenue from self storage and storage doesn’t need much parking, so as an infill space, storage could be ideal,” Boorstein said.

“My guess is that in 2016 mixed-use will pick up even more for talented entrepreneurial developers. Alone, self storage or retail might not work on a site, but together they could.”