Steady As She Goes

Business north of the border is doing well for American and Canadian companies.

By Laura Williams-Tracy

Mike Burnam, CEO of Columbia-based TKG-StorageMart and an almost 40-year veteran of the storage industry, saw opportunity in a strategic move north in 2007 when his Midwestern company bought two stores in Ontario. Just five years later, StorageMart has the largest number of stores of any Canadian competitor.

"If I were to start a new business today, I'd do it in Canada," Burnam said of the country's welcoming atmosphere and courteous business partners. "It's more business friendly. Yes you pay more taxes, but you get something for it—roads, police, benefits for employees. Canada is doing great, and it's an enjoyable place to do business."

Burnam's positive take on business in the land of the maple leaf isn't to say that doing business there is always easy. Higher taxes, stiff competition for land, strict municipal regulations, slower lease-up rates and as yet immature laws governing liens combine to tamp down rapid growth of the industry. But Burnam and others say the stable growth pattern has made Canada's storage industry an attractive investment.

"We're a little more slow and steady," said Steven Scott, president of Access Storage, based in Scarborough, Ontario, and a director of the Canada Self Storage Association. "The development process in the U.S. takes four months and here it takes a year and change. As long as you understand what you are getting into, underwrite to that and have patience, you'll get through it."

Accepting the Challenge

The challenge of breaking into or even expanding in the Canadian market is so great that when growth opportunities present themselves they are very attractive, investors say.

StorageMart purchased InStorage Real Estate Investment Trust in 2009 in a deal worth $478 million only after a misstep by the REIT. InStorage's board of directors made a move viewed by investors as a conflict of interest, sending the stock price tumbling and leaving the REIT vulnerable to a hostile takeover bid. Ultimately, StorageMart closed the deal in a friendly buyout, gaining 62 Canadian stores,

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mostly in Ontario but with others in Quebec, Saskatchewan, Alberta and British Columbia.

"We knew it was a great market, and we knew what you can afford to pay for self storage in Canada," Burnam said. "Had InStorage not overpaid for its portfolio, there's no way we would have gotten in because it's very difficult to buy existing properties in Canada."

Canada has proved to be a steady market that continued to grow—albeit at a slow pace—when the U.S. was suffering the darkest days of the recession.

Upon purchasing InStorage, Burnam said the Canadian stores implemented the approach that has made StorageMart successful in the United States, focusing on net operating income and less on occupancy. As digital marketing was taking hold, CSP worked to build a digital brand by not only renting units online but positioning the company for optimum Web presence. While the U.S. commercial real estate market was in decline, rental rates in Canada were on the rise.

"We purchased it at the depth of the downturn in the U.S. and it made us look very smart, but in reality we were just very lucky," Burnam said. "We're not so smart, but we've been around longer and made more mistakes than most people."

Access Storage sparked its own growth in 2011 by purchasing 14 stores in Quebec from Depotium.

"We're always looking to expand, but these assets rarely come up for sale," Scott said. "A lot of storage in Canada tends to be owned as an investment by small operators with other successful businesses. It's tough to motivate them to sell."

Other signs of consolidation in the industry included Edmonton-based Sentinel Self-Storage's purchase of Apex Self Storage in British Columbia, adding three facilities.

Dealing with Growing Pains

Scott says development wasn't as heady in Canada through the last decade, in part because of a tightly controlled banking system that makes storage loans harder to secure.

"In Canada, the banks view self storage as a second class citizen when it comes to lending. We're a small industry, so no one is focusing on us and they don't understand us," Scott said. "Large companies with strong balance sheets are getting financing, but entrepreneurs struggle to get financing, especially for development."

For self storage, the penurious nature of consumers means there's always a risk of overbuilding. Construction and permitting is extended and expensive in Canada, rent-ups

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take longer and rental rates are not much higher than in the states, leaving less room for error on poorly conceived projects. Land can average $1 million an acre, tightening other margins. Then there are slower absorption rates and municipal regulations that don't favor storage.

Slower absorption of storage space in Canada is likely due in part to a slightly different consumer mindset, operators say. Canadians are generally more conservative consumers than Americans, having less need for space to store possessions.

StorageMart is pursuing only one new project currently, a unique store that would offer storage on the first floor of a six-story apartment building in downtown Toronto. The project has been in planning stages for more than two years. It's an indication of how selective developers must be in the market to ensure a profitable store. "Those most profitable are always the most difficult," Burnam said.

During the storage boom in the mid-part of last decade, Burnam said, Canadian storage developers attended the U.S. trade shows and took away ideas for bigger and better properties. The result is that some Canadian markets are overbuilt. Other markets are still underserved.

"The Canadian market is at about equilibrium," Burnam said. "In the U.S., it's a mature industry. In Canada, it just turned 21 but it still thinks it's younger."

With maturity comes increasing focus on legislative issues. In recent years, Scott said, CSSA has worked with provincial governments to increase awareness of how such issues as property taxes, lien laws and active and passive business classifications affect the industry.

"One challenge is that each of the provinces has different legislation," Scott said. "What we try to do is deal with an issue in one province and roll out that legislation to other provinces."

Of particular interest to operators is whether storage businesses are taxed based on cost, which has historically been the norm. A new effort in some jurisdictions, especially in Ontario, is to assess storage businesses based on income or market value.

Smaller storage businesses with fewer than five employees are also sometimes classified as passive income for owners, subjecting them to a much higher tax rate. "Small motels have had the exclusion for years, so it's especially important to our small operators. It's a major initiative."

With few lien laws, Canada's storage industry remains young and is experiencing some growing pains. "We worked on these issues 25 years ago in the states and it's just now coming to fruition in Canada," Burnam said. "They've got their own mind and own way of looking at things that's different from the U.S." ❖