Going to Market: Long-Range Planning Helps Self-Storage Sellers Build Value Prior to Sale

http://www.insideselfstorage.com/
By:
Posted on: 12/17/2010

PRINT

By Jeffrey Supnick

With credit availability increasing, property performance stabilizing and interest rates at their lowest in decades, it's no surprise self-storage sales-transaction volume is increasing. Here are some guidelines if you're intending to list a self-storage facility for sale. They will help you prepare for the transaction and build more value into your asset.

In large measure, buyers and sellers are beginning to once again find common ground on pricing. Sellers feel they're receiving appropriate value for the cash flow generated from their self-storage assets, and purchasers are paying prices in which they're comfortable and can still realize upside potential on their investment.

While market fundamentals have improved, a prospective seller should understand today's self-storage buyer is more disciplined and sophisticated than in past years. In addition, buyers continue to be very reluctant to overpay for properties as they may have done in the past. Former Federal Reserve Chairman Alan Greenspan, in referring to the days of the dot-com stock market bubble era, coined the phrase "irrational exuberance." This could have also been applied to the self-storage investment market during the period prior to recent financial crisis.

During that exuberant period, there was a great deal of competition for self-storage acquisitions. Escalating operating results made up for mistakes on the part of purchasers, who were willing to pay premium prices to "win deals." Banks were feverously doing whatever it took to make loans, and were willing to overlook more rigorous underwriting criteria to maximize loan production.

While loan availability is now up, banks are by no means taking their eyes off of the ball. In today's market, if a buyer is overly aggressive on pricing, his banker will be more reluctant to loan on such a mispriced transaction. For this reason, it's imperative that a potential seller has a professional, unbiased valuation of his self-storage property.

A valuation analysis should be prepared by a knowledgeable broker or appraiser familiar with self-storage, one who provides a prospective seller with a basis for gauging buyer offers. The valuation will give you an idea of what you can reasonably expect to net from a sale. It will also reveal your business market position, financial situation, strengths and weaknesses, which you can hopefully correct prior to putting the property on the market.

Planning Ahead

Since self-storage properties are purchased for their cash flow, the most appropriate method of calculating valuation is based on capitalization rate. The cap rate is expressed as a fraction or percentage which, from the purchaser's point of view, predicts the return he'll derive from operating the storage business, based on a particular purchase price to be paid.

To determine that rate of return, an investor needs to fully comprehend the expected income and expenses that are likely to be generated from your business. The difference between the income and expenses before consideration of debt-service payments, depreciation and income taxes is what is known as the net operating income (NOI). A great deal of confusion arises from the use of cap rates because it's possible to state operating expenses in ways that do not fairly address true costs of operation.

What a particular owner spends to operate his property may not be equal to what a typical purchaser might spend. Normal expenses should include actual repairs made on the property, a consideration of a reserve fund for future replacement of building components based on expected remaining years of service, all maintenance expenses including do-it-yourself items such as minor repairs or lawncare, and a reasonable management fee.

It's never too early to plan and implement operation procedures that will increase the bottom-line results of your balance sheet, even if you don't have plans to sell your facility in the near future. The process of improving revenue often takes time to accomplish. An owner needs time to make the accounting and operational changes that will put his self-storage operation in the best financial light.

Building the Bottom Line

The rewards can be great. Assume a cap rate of 8.5 percent will be an additional increase in your store's NOI of $8,500 and result in an overall increase in the value of your self-storage asset of $100,000. Let's examine some steps in which you can begin today to create more value in your facility.

Rental-rate management. Most purchasers want to see a trend of increasing revenue to be certain such improvements are long-lasting. For example, there's a difference in the mind of a purchaser between rental-rate increases that were put into effect last month as opposed to a year ago.

Percent occupied vs. total revenue. What many self-storage operators have come to find out lately is their physical occupancies have maintained fairly well, but there has been some pressure on rental rates and concessions to maintain such occupancy. Remember that what the sophisticated investor is purchasing is cash flow, not physical occupancy.

The hotel industry uses a standard called REVPAR, which stands for revenue per available room. This metric is obviously different from a standard of percentage occupancy. As operators, we must continually review our operations to focus on rent per available square foot. This can be accomplished by managing rental rates to either encourage the renting of problem-sized or excess spaces in inventory, and maximizing profit on space categories and sizes in short supply. Again, advanced planning is called for since this process requires time for maximum impact.

Delinquent tenants. Owners are sometimes reluctant to conduct auctions on delinquent units and eviction of "deadbeat" tenants, fearing that the decrease in physical occupancy will put their self-storage facility in a poor light. Instead, we encourage owners to think about how they will maximize rent per available square foot. Is a particular tenant paying you a little at a time on a large delinquency? Could such a tenant be replaced with a well-paying one?

Property-tax appeals. Inappropriate tax assessments on self-storage properties are perhaps the single largest expense item that can adversely impact your NOI and the price you're likely to receive. In recent years, local governments are experiencing extreme financial pressure. At the same time, assessors from taxing authorities have taken notice of the very handsome prices paid for self-storage facilities. The assessors have often used that information in assessing self-storage at ever-increasing value, resulting in higher property-tax bills.

Many self-storage buyers have discovered after a sale that taxes on their properties have gone up significantly and, consequently, their anticipated ROI has turned out much lower than expected. Whether or not you determine a property-tax appeal is in order, you should fully understand your assessment and whether a sale of the property at a given price will have adverse or perhaps even favorable tax consequence to the new owner. Many prospective purchasers will automatically project higher real estate taxes where such assumptions are unwarranted or, even worse, where a strong argument could be made for a reduction in taxes, which would actually add value to a sale.

Once you have actively started the sale process, keep your eye on the ball. Don't let your operating performance decline because you're too focused on the sale of your facility. Many purchase and sale contracts have a provision for purchase-price adjustments or cancellation if operating performance declines during the period between contract execution and closing.

Jeffrey Supnick is president of Supnick Real Estate Co. and a 25- year veteran of the self-storage industry. He has formerly served as a real estate officer for Public Storage Inc. and Storage USA. During his career, he's been responsible for the development of more than 30 self-storage sites. Supnick Real Estate is a full-service firm devoted exclusively to self-storage brokerage, consulting and property-management services. For more information, call 856.722.1414; e-mail jeff@supnick.com; visit www.supnick.com.