

Are Self-Storage Margins Shrinking?

A Look At Increased Costs And The Question Of Industry Overbuilding

By Rhonda Paschal

Every business owner knows the importance of evaluating its strengths and weaknesses. The strong areas always have to be fine-tuned in order to maintain their strength and retain a competitive edge, while the weaker points of a business sometimes need to be revamped, streamlined or eliminated altogether to yield more profitable results. The self-storage business is no different. In fact, many self-storage owners and operators have had to become even more diligent about finding ways to increase their revenues and curb their expenses in an effort to deal with profit margins that are being squeezed by numerous factors such as increased construction prices, skyrocketing insurance costs, property taxes, higher salaries, increased design costs and various operating expenses. Here, industry experts not only address the issue of whether self-storage margins are shrinking, but they also pinpoint the contributing factors that affect a business's bottom line.

Are Margins Under Siege?

According to Cris Burnam, president of Columbia, Mo.-based StorageMart, margins are most definitely being squeezed. "Profit margins are under siege due to overbuilding," he says. "What this computes to is lower occupancy and the inability to raise rents...and a contributing factor to that is our low inflation rate." Admitting that the industry is experiencing overbuilding and can't raise rents any faster than inflation, Burnam adds, "If we want to cut our costs, there is not much out there that we can cut."

Acknowledging that there are two factors that make up margins (revenue and expenses), Burnam offers the simple explanation that "if your revenue is shrinking, you obviously have a problem, and if your expenses are growing while your revenue is shrinking, then you have a very big problem." The challenge lies in finding a balance between the two—something Burnam admits is not an easy task. He adds, "In the storage business, we have relatively fixed costs such as property taxes, utilities and insurance, all of which I can't do anything about. However, the one item out there that I have control over is payroll, and we've seen some huge payroll increases in recent years. That's because it is getting harder to find quality people who want to run a self-storage facility."

Ray McRae of Storage Solutions, based in Mesa, Ariz., not only can attest to what Burnam says about the industry experiencing shrinking margins, he can also attest to the role increased salaries play in the situation. "Growth in our industry has produced overbuilding in many markets," he states. "As a result of the cost to retain a competitive advantage in the marketplace, we're seeing increased personnel costs because we want the brightest and the best sales-oriented, customer service people on staff at our properties. We're hiring with higher salary packages than in the past to attract the best qualified individuals for the job."

Obviously, to attract high quality personnel, industry-related companies also have to offer the best benefits package. These benefits/hiring packages go beyond salary to include living quarters for on-site managers and assistant managers, retirement packages and health insurance. With the cost of health insurance premiums increasing at a phenomenal rate over the past several years, offering this benefit poses a big challenge—and costs companies a lot of money.

“Health insurance premiums, which have increased at an exponentially higher rate over the last five years, also contribute to shrinking margins,” says McRae. “In addition, many companies offer employees 401K programs, IRAs and other retirement vehicles with companies matching up to certain dollar amounts.” He also notes that the cost associated with recruiting the best people has gone up with the more sophisticated operators paying for more thorough and detailed background checks, as well as spending more money to place larger ads or to run additional advertisements in trade publications.

While more money is being invested in attracting the best candidates for jobs in the self-storage industry, organizations like Storage Solutions are also investing more money in ongoing education and training for its personnel—all of which chip away at profit margins. “We’re sending our managers to more seminars for customer service and sales,” says McRae. “We’re also buying more training materials for our managers.”

Other Factors Affecting Margins

While industry experts agree that manager and employee salaries have a definite bearing on profit margins, they also acknowledge that other factors have the potential to affect margins. Those factors include the very obvious increase in development costs.

“There are definitely pressures on margins as a result of things like increased costs of construction,” says Steve Tyler, Vice President of Operations for Seattle, Wash.-based Shurgard Storage Centers, Inc. “Also, contributing to the pressures are the demands that cities make regarding the look and design of facilities. Cities expect additional design features because they feel that it helps the appearance of a self-storage facility to blend in with the [overall look of the neighborhood]. Cities don’t like the warehouse look or feel of storage facilities.”

Echoing Tyler’s sentiment, Harold Leslie, President of Leslie Industries, Inc. in Tallahassee, Fla., has seen design costs go up due to requirements imposed by local officials and city ordinances. “In the markets where we are building multi-story, we have seen significant increases in the costs of the buildings due to added architectural flavor which is being demanded by the communities in which they are being built.” In regards to the price of construction and whether he feels it factors into shrinking margins, Leslie says, “The costs have gone up dramatically, driven primarily by new codes—both structural and fire codes. These have had significant impact in increasing the cost of building, especially multi-story self-storage facilities.”

McRae, who also agrees that construction costs have risen, notes that when it comes to constructing new buildings, the increased land costs, higher architectural and engineering costs, impact fees, and higher building permits, among other things, can also contribute to shrinking profit margins. When considering building new facilities, he recommends doing your homework and addressing some important issues. “Before you build, you have to decide what the desired rate of return is on your investment, then create a financial model of the facility in the specific market. In other words, before you build a \$3 million self-storage project, you need to do due diligence.”

—Harold Leslie, President, Leslie Industries

When examining other areas affecting margins, Tyler notes, “Insurance costs, especially since 9-11, have definitely gone up and also contribute to the pressures being inflicted upon profit margins. Another contributing factor having some bearing on margins is property taxes. Each year, property taxes go up but we expect that to happen. Most REITs are associated with specialists who ensure that they are being handled fairly by municipalities when it comes to property taxes.”

Also touching on the subject of property taxes, Leslie, who is both an owner/operator and a building supplier, says, “We have learned that bureaucrats in either city or state governments meet to discuss how to raise taxes. The taxing authorities now ask us for financial statements once a year even though we are not required by any law to provide this information. However, the municipal authorities already know the exact square footage of the project. They also know the rental rates because they either call and get them or come by to rent a unit, and then base their increased taxes on our increased income.”

According to McRae, the amount by which a property's taxes increase can vary from location to location and are generally all over the board. "This year [2002], none of the property taxes stayed the same for our entire portfolio," he says, adding that it's getting difficult to win property tax appeals—and unsuccessful appeals leave operators stuck with paying the assessed amount, which can cut into margins.

With operating costs such as utility bills and salaries having the capability to contribute to shrinking margins, facility operators are offering amenities designed to make self-storage more convenient for their customers and hopefully improve their revenue stream. Some locations offer office suites equipped with computers that have Internet access, fax machines, printers, copiers, as well as onsite access to postal and package pickup and delivery services.

While these features offer numerous customer conveniences, do they also have the potential to dig into margins? Because there are costs to maintain and stock these machines, they can have an impact, as can other services such as call centers and electronic payments. "Call centers are big right now," says McRae. "But it costs money to run a call center just as it costs money to offer online payments. As we make it easier and more convenient for the customer, accepting all the bank and credit card processing fees associated with these services helps to erode profit margins."

Dealing with Shrinking Margins

Operators are evaluating different ways to adjust margins and stay competitive in an industry where overbuilding has become the norm. StorageMart is looking at ways to reposition their older stores with rehab projects, climate-controlled conversions and other efforts that serve to enhance and update their established locations. Additional efforts to stave off shrinking margins include the company measuring its employees on lock penetration, while enforcing the sale of products like boxes, tape and other accessories as a staple of the business, not simply as an additional option.

Enhancing what they already have is only part of the equation for StorageMart. The other part of their plan includes being the biggest and the best! "Because we've lived through the bad times at our old stores, we want to be as competitive as possible with our new stores," says Burnam. "To do this, we pick the biggest and the most awesome locations, then we construct a beautiful, first-class facility that offers more than any other competitor in that market."

Burnam admits that the most appealing situation for the company is one that allows them to come into a market and build a new superstore that is going to compete against old metal sheds in a poor location. He emphasizes, "Times are tough in the storage business so you'd better have a competitive edge."

Assessing the situation from another viewpoint, Leslie says his company deals with shrinking profit margins "by doing those things that we can such as reducing advertising, being careful about [hiring] additional personnel, reviewing overhead and expenses carefully and reducing them wherever we can."

Advice for Going Forward

Many operators have learned over the years how to plan for and deal with shifting profit margins. For those new to the industry or who are just looking for ways to offset costs wherever possible, there are ways you can control some costs. When it comes to those costs in your power to control, McRae advises operators to look at contract labor for certain jobs, as well as analyze the cost of materials, make firm rules regarding the bidding process and decide how it should be handled and by whom. Also, know when to use a professional versus an onsite manager for certain jobs.

When you're talking about shrinking margins, it is just as important to look at how much you're spending on what can be considered the small things (such as office, cleaning and maintenance supplies) as it is to evaluate big things like construction costs, utilities, advertising, property taxes and facility designs. Both Tyler and McRae encourage owners and operators not to lose sight of obtaining the desired results.

"Try to build in competitive advantages that allow you to get top value for your product and hopefully that value will get you the return you desire," says Tyler. "Also, operators have to understand what adds value

to their property and eliminate those areas that don't add value for customers. The smart operators value engineer their construction projects. And good value engineering assesses those features that add value and those that don't."

Tyler explains that it is important to value engineer properly and make sure your investment is giving you a payback as much as possible. "As for the independent operator," he says, "it is important to watch the larger expenses like property taxes and challenge unfair assessments, making sure you are being treated fairly when you go through the appeals process. When it comes to the larger expenses like property taxes, you have a better chance of winning an appeal if you consistently pay attention."

Although owners and operators may not be getting the same return as they may have 10 years ago, McRae says, "you're getting the best return you can in today's competitive market," a market in which the cost of doing business is more than it was a decade or more ago. To ensure long-term success and strength in today's competitive market, certain measures have to be taken.

"You have to constantly evaluate the business and your bottom line," McRae explains. "Sometimes you have to make certain decisions and changes that will hopefully improve or reduce expenses in some areas, thus helping your margins in the long run."

The decisions McRae is speaking of are operational changes that self-storage owners and operators are oftentimes reluctant to initiate. They include courses of action such as charging administrative fees, increasing rents, and offering retail services such as the sale of moving supplies or the addition of other revenue-generating conveniences. The fact remains that offering value-added services has become a necessity—and not implementing them can, in turn, eat up profits.

As an owner of several self-storage facilities across the country, Leslie has had to make the decision to increase rents at his locations in some markets. For him, the results did not yield a negative outcome, which may be what other operators facing the reality of raising rental rates fear. "We have raised the rents on two of our properties year after year and we have not lost any clientele as a result of that," Leslie says. "On one property, the rent has stayed the same this year as last year, and on the other two properties, we have either stayed the same or have reduced the costs of some of the different sized units. We have found that in the markets where the rents have stayed the same or where we reduced our unit price the need for this was a result of overbuilding in those particular markets."

Offering advice from his viewpoint as a supplier, Leslie encourages companies going forward to "try to come up with new innovations and technologies in building so that we can build the buildings faster and increase our margins there. From the point of view of an owner/operator, I would advise anyone getting into owning self storage to be sure to have a demographics study done to be sure the area you are looking to buy or build in is suitable for self storage before you buy or build."

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