On the Rise

The number of management firms in the storage industry is growing at a rapid pace.

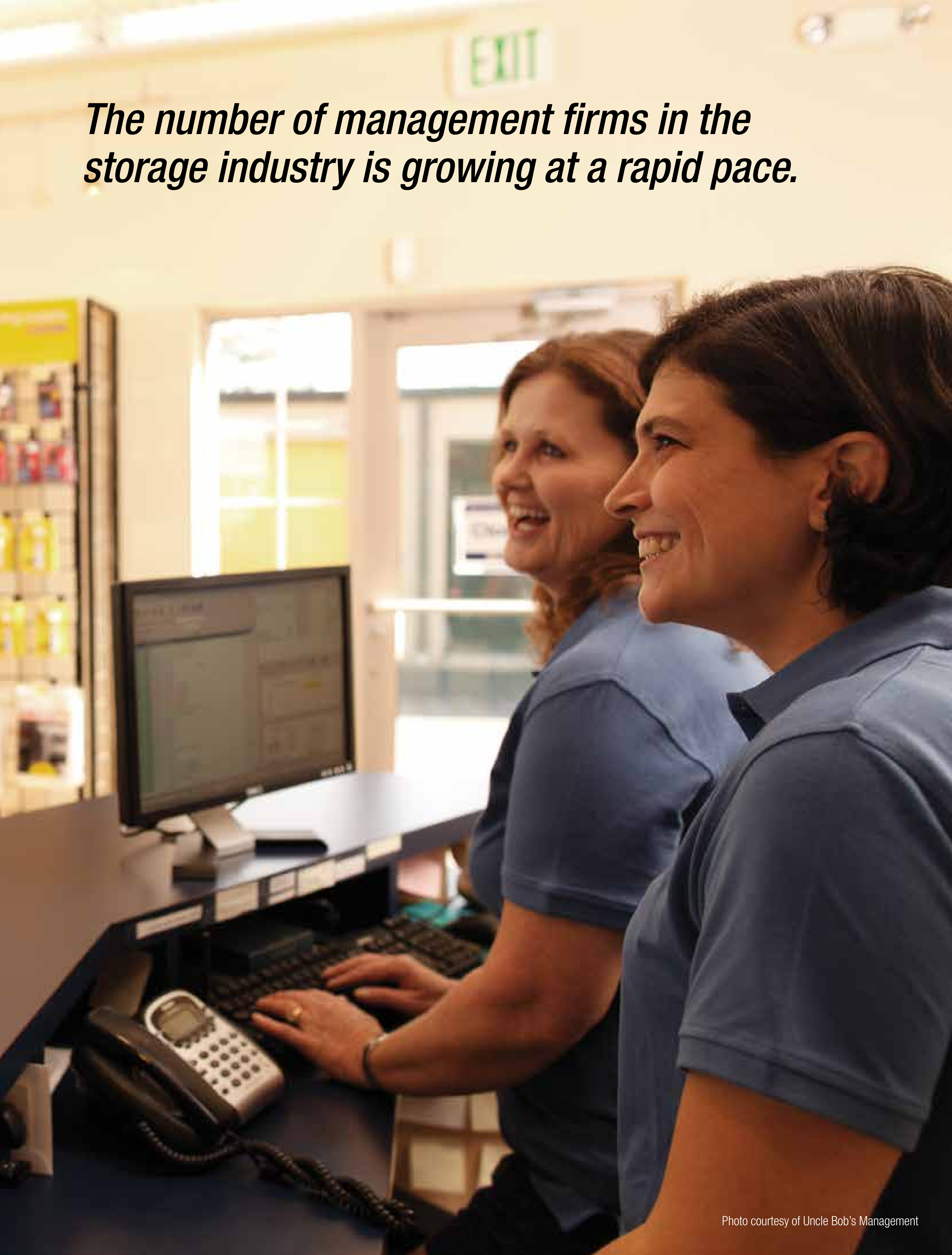

Photo courtesy of Uncle Bob's Management

By Laura Williams-Tracy

Look no further than the exponential growth of third-party management contracts in self storage to see how the once-simple business model is becoming increasingly sophisticated.

In three years, the Self Storage Association's registry of management firms has grown from 33 companies in 2012 to 122 management firms. That's a 270 percent increase in firms that are managing more than 5,000 facilities.

Regional operators see third-party management as a way to add another revenue stream by selling their expertise, learning new markets and increasing their platform. Often those relationships result in the manager buying the facility. The same goals are shared by large REITs, such as Extra Space and CubeSmart, who now view third-party management as the most efficient route to acquiring high-performing properties after a successful management period.

"You need to know all the same things to run one facility as you do to run 10 or 40 or 100," said Drew Monson, president of Aberdeen Management in Tucson, Arizona. "Small operators are exposed to all the same risks and competitive environment as the large operators. You can be the smartest guy on the block, but it doesn't matter how good you are if you expect to compete effectively as a single individual running one facility against the REITs that have 2,500 facilities."

For a going rate of about $2,500 per month and five to six percent of gross revenues, third-party managers large and small are offering to manage all aspects of facility operations, including central reservations, human resources (even hiring and training), bookkeeping and the ever-important digital marketing.

The Digital Drive

Marketing is easily the biggest hurdle for smaller operators, said Noah Springer, vice president of business development for Extra Space, the largest player in the third-party management arena. Without the scale or ability to collect data like a larger operator, smaller operators have less information available to help them make decisions about when to raise rents and when to offer discounts, and when not to.

"ExtraSpace is a real estate company that does self storage, but it's also a data and marketing company," Springer said. "The data we have is one of the biggest assets in the company."

Marc Boorstein, principal with MJ Partners Real Estate Services in Chicago, says digital advances are increasing the opportunity for secondary locations in high barrier-to-entry markets, where before those facilities weren't top performers. That's a major shift in the industry, Boorstein said.

"The business has changed so quickly that the managers have become more important than ever before," said Boorstein.

In the past a potential customer might consider three or four facilities based on location and appearance. Today most renters are shopping at the first facility that appears in their Internet search.

"Some companies are getting 70 percent of their rentals from customers on their mobile phones," Boorstein said.

Extra Space spends nearly $30,000 a month on Google advertising, Springer said. That's a lot of horsepower to get in front of potential customers as they search online for storage. And Extra Space is able to spread that substantial cost among more than 1,000 properties, 300 of which are owned by individuals and small ownership groups who alone would have much smaller marketing budgets.

> ***"... scale is an advantage when it comes to purchasing power to buy office supplies and cleaning supplies. The bigger you are the lower cost you get."***
>
> ~ Guy Middlebrooks, CubeSmart

"We spread that cost over a very large base," Springer said.

Guy Middlebrooks, vice president of third-party management for CubeSmart, said it makes sense to add the management of new facilities to a region that already has a district manager in place.

"It's very scalable and the scale is an advantage when it comes to purchasing power to buy office supplies and cleaning supplies. The bigger you are the lower cost you get."

CubeSmart had 174 properties under management at the end of 2014 and has added new partnerships this year, Middlebrooks said. CubeSmart has doubled the number of facilities it manages since 2010.

For the large REITs, third-party management started as a way to develop an acquisition pipeline. During the course of the management contract, the REITs are able to meet the owners and build relationships and be nearby when the owner is ready to sell. Because the REIT has already managed the property, it knows the facility's strengths and weaknesses and potential for revenue growth.

Uncle Bob's is committed to growing its third-party management services for properties that it would like to acquire at some point, said Dale Payne, sales manager. The company operates 23 facilities as third-party managers and another 55 properties as joint ventures.

"If a property meets the criteria of acquisition but an owner is not ready to sell, then it would become a management

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opportunity," Payne said. "The second half of 2014 and going into 2015, the need for third-party management has grown for conversion and new development opportunities. So we have seen an increase in contracts for these types of projects."

Payne says Uncle Bob's has human and financial resources that a smaller operator wouldn't necessarily employ. With 500 stores, Uncle Bob's is able to spread out costs and feed revenues into a multimillion-dollar budget for Internet marketing.

"More often than not, the technology involved and Internet presence needed to compete against the larger operators is beyond what the owner wants to keep up with," Payne said.

David Blum of Better Management Systems used to offer third-party management but now focuses on consulting with first-time developers. He's sold on third-party management.

"I tell them to go with one of the REITs because I think they are doing a great job," Blum said of his development clients. "You've got to be nuts to not go with them, and this is from the guy who at some point competed with them."

Boorstein said he sees third-party managers delivering impressive occupancy rates of 94 percent and even better. Because of their sophistication, they have the expensive Internet presence to drive traffic to the facility and enough data analysis to know when to offer discounts and when not to, when to raise rents and when not to.

Other Opportunities

CubeSmart and Extra Space have chosen to not develop properties themselves and instead work with local developers and through their management relationships to find new properties.

Because the environment is good for new development, Middlebrooks said many third-party clients choose to turn over management of their facilities so they can focus their time on new development.

A desire to do something other than manage the day-to-day headaches of an independent facility or two is leading many Baby Boomers—many of whom birthed the self storage industry 30+ years ago—to turn over management to someone else.

"When those people reach that age in life, they are cashing out," said Blum. "With cap rates the way they are, we are seeing more of that happening."

Those facilities going to institutional investors automatically need someone to step into the management role, and a non-owner manager is the obvious choice.

Middlebrooks of CubeSmart said he's seen lenders recommending or requiring that developers partner with a repu-

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table third-party manager in order to optimize revenue and ensure that the bank's investment proves fruitful.

Monson of Aberdeen Management said it's a generational reality that older owners, especially those without a good succession plan within the family, are looking outside for management help.

"Frankly, a lot of owners are approaching retirement age and they are ready to take their foot off the pedal and reap the benefits of what they built."

Turning over a facility to another management company doesn't come without upheaval. Long-time employees and vendors are often replaced by those already serving the larger management company.

Extra Space asks the employees of the joining facility to apply for their same jobs with the new company. Springer said on average about 70 percent of employees come over to Extra Space, but few stay as the culture changes from a small business to a more corporate atmosphere.

> ***"I think there's room for companies that have the sophistication to compete with large operators but can also offer that personal touch."***
>
> ~ Drew Monson, Aberdeen Management

Some management firms require that the facility rebrand to the management company's name to better assimilate to its marketing platform.

The Pegasus Group, based in Walnut Creek, California, has all properties managed convert to Central Self Storage, said Dwight Davis, Pegasus' senior partner.

Davis said some owners don't want to give up their previous identity, but he said that's happening less today than five years ago. The Pegasus Group owns 50 self storage properties in 10 states and manages six others.

CubeSmart does not require managed properties to rebrand from their original facility name, but Middlebrooks said the vast majority choose to do so.

"We will take on one facility if the store fits our operational ability," Springer said, adding that a facility with fewer than 400 units might be the tipping point for being too small to add to the network.

Blum said he tells developers they will do well with third-party managers, but they need to decide whether they want to deal directly with the owner of the management firm or if they are comfortable turning over their facility to a larger, less personal corporate entity.

"You can get a more personalized relationship than with the REITs that have many levels of management," Blum said. "They are much more corporate and the smaller guys are more flexible. There's a market for both."

It's estimated that 80 percent of the self storage industry is owned by mom-and-pop single operators. Third-party managers see gold in that statistic. Extra Space is bringing in 50 to 60 new facilities a year. That's more than one a week. CubeSmart is equally busy.

"There is a tremendous amount of opportunity to continue to add storage to our management platform, and that's not even considering the new development coming online," Middlebrooks said. "We are confident that we will grow the platform for at least the next several years."

Aberdeen Management, which owns and operates nine facilities in Arizona and California, just launched its third-party management services in 2015 and was closing a deal to bring two facilities in Nevada and Idaho under management in the first quarter.

"We put the word out to people in the industry at the first of the year. The response has been much quicker than we expected," Monson said. "I think there's room for companies that have the sophistication to compete with large operators but can also offer that personal touch." ❖

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