

## Los Angeles, California

### How Is Self-Storage Faring In The City Of Angels?

BY R. CHRISTIAN SONNE

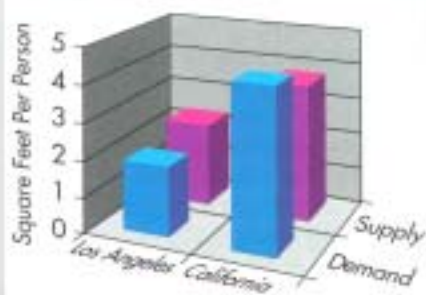
**L**os Angeles is often called the city of angels, derived from the Spanish origin of the city name. In the self-storage market, the angels can be elusive in this immense region.

Consisting of a geographic area over 34,000 square miles, the Los Angeles region includes five counties extending from the Pacific Ocean east to the California-Arizona border. Fueled by a population of 17 million people, the Los Angeles region has among the most diverse and large economies in the world. Based on 1999 gross regional output of \$537 billion, the regional economy is exceeded by only 10 nations in the world, surpassing India in 1998 (IMF). Los Angeles County by itself ranks as the 15<sup>th</sup> largest, while the State of California ranks seventh, just before China.

#### Self Storage Market Conditions

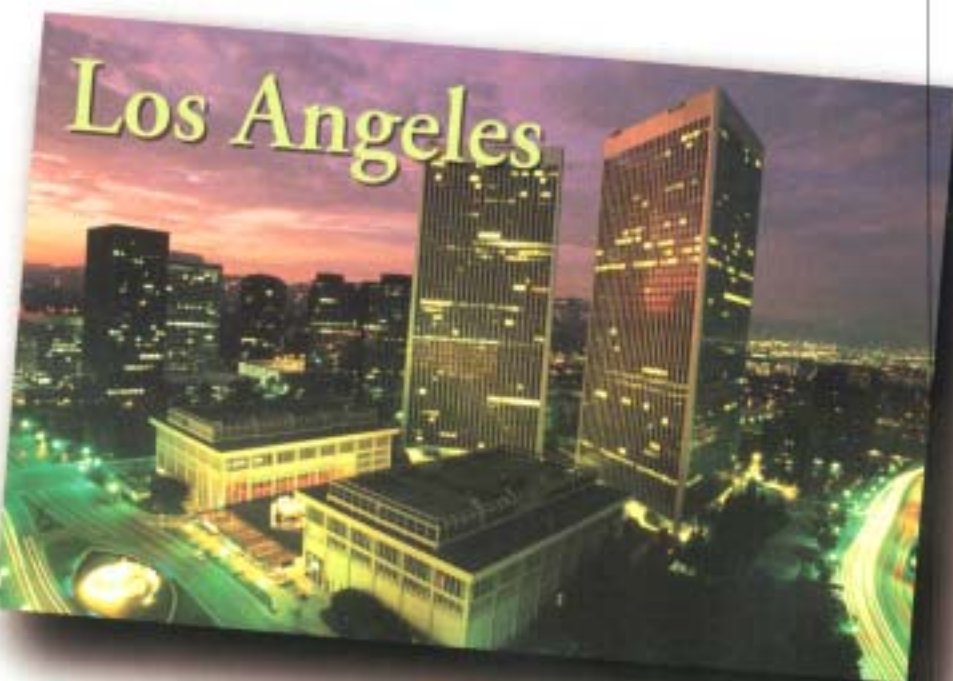
In terms of self-storage supply, Los Angeles County and California are below state and national averages. In peer group analyses of the United States by state, the 2003 *Self-Storage Almanac* reports that existing supply is 3.79 square feet per person compared to existing supply nationwide of 4.33 square

Figure 1 Supply & Demand



feet per person. Moreover, Los Angeles indicates a supply of 2.20 square feet per person compared to demand of 1.92 square feet per person (essentially at market equilibrium).

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Yet, there remains significant new development searching for the under-supplied neighborhoods or angels within this huge region.

In California, beginning in 1995, self-storage REIT's aggressively acquired properties in single and bulk transactions. These transactions increased the price structure and lowered overall capitalization rates. However, REIT's have particular investment criteria and only first tier properties meet portfolio requirements. These transactions

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seemed to culminate in 1997 with the bulk purchase by Storage USA of the In Storage portfolio comprised of 20 properties throughout the Los Angeles region. More recently (August, 2000), Extra Space Properties sold a \$40,000,000 regional portfolio to General Electric Capital, including self-storage properties in Burbank and Inglewood, Southern California Edison, seeking to raise cash, listed for sale a portfolio of power easements (land leases) available for self-storage development. A newcomer to self-storage now controls this portfolio, and the property is beginning to be developed. A StorAmerica portfolio,

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*Self-storage growth in the City of Angels has risen substantially over the last decade, with nearly one million square feet developed over the last two years alone. Photo courtesy of Michèle and Tom Grimm, Los Angeles Convention and Visitor's Bureau.*

comprised of 23 self-storage properties in California, Nevada and Arizona, was offered for sale as one transaction. In 2002, three of seven transactions were U-Haul (Amerco) facilities sold in bulk, facilitated by a blanket mortgage by Merrill Lynch for \$65 million.

Brokers such as Don Clauson of Commercial Property Consultants and Dean Keller of Bancap Self Storage report a decline in first-tier transaction activity. For example, the amount of single unit transaction activity is among the lowest in years. With limited supply of properties for sale and relatively low cost of capital with wide availability,

**There are over 600 facilities representing over 20 million square feet, with nearly one million square feet developed over the past two years.**

there has been aggressive new development among REITs (such as Public Storage and Shurgard), regional operators (Stor-It and CT Realty) and a plethora of individual developers. Data trends in the Los Angeles region, as measured by self-storage transactions, are summarized in Figure 2.

According to Robert P. Bihr, a lender with East West Bank in Los Angeles, there is strong competition for self-storage product. Buyers are looking for stable cash flow leveraged with long term, low cost financing. Clearly, there are more buyers than sellers. However, financing angels are also hard to find.

"We are beginning to focus on credit quality in addition to the collateral value of the self-storage facility," Bihr notes. "We are looking to get a handle on supply and demand issues because we have concerns about lending in over-supplied

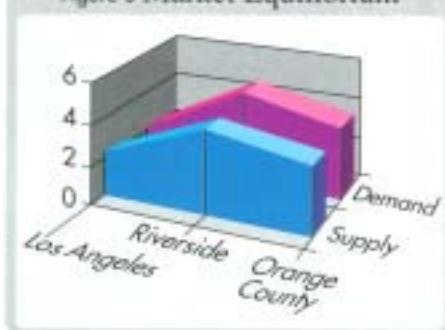
markets. Getting a handle includes market studies or appraisals that specifically address the conditions of supply and demand in the target trade area." Bihr also notes that "most of the focus in market studies is on existing supply, however, we are requiring more analysis on demand side issues."

#### Looking At The Numbers

Self Storage Economics has completed demand studies by major markets as published in the *2003 Self Storage Almanac*. Major markets in the Los Angeles Region are summarized in Figure 3. As demonstrated, major markets

past two years. Yet, vacancy remains low, fueled by demand generated in the region by population and job growth. Occupancy is higher among newer facilities that represent the latest in security and fire-life-safety technology. The average age of the existing product is over 10 years old. Specifically, vacancy at stabilized product is 11 percent—another

Figure 3 Market Equilibrium



in the region are at equilibrium. What is interesting is the variance in the level of demand among these three counties within the same region.

This underscores the need for local, trade area analysis to get an accurate snapshot of the self-storage market for a particular project. In this regard, developers are expressing growing concerns of over-building, particularly by newcomers to the industry. Development strategy is now focusing more on long term hold in a unique market niche including container storage and adaptive re-use of existing industrial buildings (change in the highest and best use).

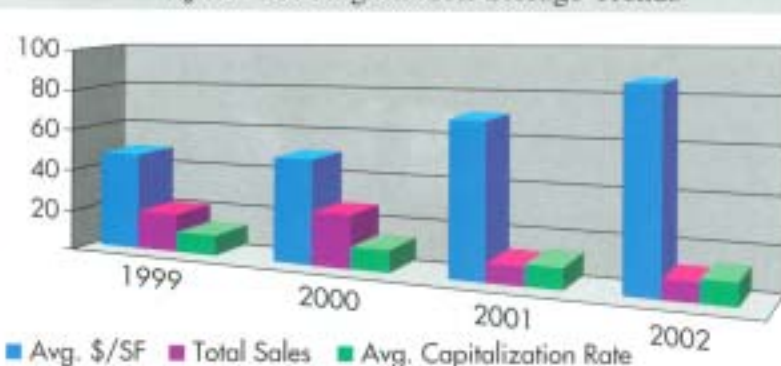
A comprehensive survey of self-storage product in Los Angeles County reveals some interesting statistics. There are over 600 facilities representing over 20 million square feet, with nearly one million square feet developed over the

indicator the market is near equilibrium. Responding to market conditions, new self-storage construction continues in the region, leading to concerns of overbuilding, rising vacancy and flat rents. Totalling over 200,000 units, an average unit size is approximately 100 square feet. Rental rate data, in terms of range and averages, is presented in Table 1 on page 79.

The data demonstrates a huge range to match the huge geography. Some West Los Angeles neighborhoods command premium pricing among the highest in the country. Conversely, facilities in remote, desert locations set the low end of the range. A typical proforma for an income and expense summary in Los Angeles County will include income based on \$15.00 per square foot per year (including ancillary income of three percent to five percent, with 10 percent vacancy and 32 percent expense ratio indicating a net operating income per square foot of \$9.18. Utilizing survey research (Investor Survey, October, 2002, *Mini-Storage Messenger*), a benchmark overall capitalization rate of 9.50 percent is typical.

Operating expenses for self-storage in Los Angeles are on a full service or gross basis, meaning all building operating expenses are paid by the owner, including fixed and variable expenses. Fixed expenses do not vary with occupancy and include real estate taxes and insurance. Variable expenses vary with

Figure 2 Los Angeles Self Storage Trends



the level of occupancy and include the following: repairs and maintenance, administration, on-site management, off-site management, utilities, advertising, and miscellaneous expenses. Self-storage property rarely incurs reserves for replacement. Due to a relatively low break-even point with respect to occupancy, self-storage expenses tend to be relatively inelastic or stable (in terms of total amount).

Some operating expenses are no angels! Property taxes in California are limited by the Jarvis-Gann Initiative known as Proposition 13. Enacted in

1975 to reduce property taxes, the act places constitutional restrictions on the method of valuation and assessment of property taxes. In affect, the maximum tax rate allowed under this proposition is one percent (plus an increment for pre-existing bonded indebtedness) of market value. Market value assessments can only be increased by a maximum of two percent per year, except when a property transfers or undergoes major construction. This is to the advantage of properties that don't transfer ownership, but taxes must be adjusted in the income summary to reflect "market" based taxes

(usually the sales price multiplied by the tax rate). Property taxes in Los Angeles are among the highest in the country.

Insurance includes both building and liability insurance expenses. An upward trend in insurance rates has been significant to real estate in Los Angeles and is slowly impacting self-storage property. Poor yields by industry investment (in equities), concerns over real estate security, and flat rates over the past decade has caused large increases for some properties. Lower rates can be achieved by blanket policies with significant rate reductions. Due to the complexities of insurance, it is critical that insurance is purchased from companies that know and specialize in self-storage.

In summary, data and statistics compiled indicate self-storage market conditions in Los Angeles can be angelic. However, due to the enormity of the market and high price points, there are added complexities to finding these angels. The key to the angels, local market players agree, is local market research. ■

Table 1 Monthly Rental Rates in California

Unit Type	Low	High	Average
5 x 5	\$20.00	\$149.00	\$52.00
5 x 10	\$33.00	\$185.00	\$85.00
5 x 15	\$46.00	\$229.00	\$105.00
10 x 10	\$59.00	\$299.00	\$140.00
10 x 15	\$75.00	\$425.00	\$175.00
10 x 20	\$96.00	\$699.00	\$240.00
20 x 20	\$145.00	\$800.00	\$360.00