



# Operating Expenses:

## Are They Still On The Rise?

By R. Christian Sonne, MAI

Over the last year, self-storage operating expenses increased slightly in terms of expenses per square foot, but declined as a ratio of collected income. According to the *2007 Self-storage Expense Guidebook*, nationwide operating expenses average \$3.81 per square foot, an increase of 1.33 percent over the national average of \$3.76 per square foot last year. As a function of rising income, operating expenses expressed as a ratio of collected income also declined slightly to 37.37 percent.

An analysis of operating expenses can yield further insights into real estate cycles and trends. For example, the rising trend in values over the past eight years is primarily a function of declining capitalization rates relative to interest rates. Net operating income has only increased 27.89 percent (3.12 percent compound rate) over the eight past years (or about even with the rate of inflation) as the average price

per square foot has increased 68.26 percent, a compound rate of 6.72 percent per year. Meanwhile, capitalization rates declined 27.89 percent or a compound rate of decline of -3.12 percent annually.

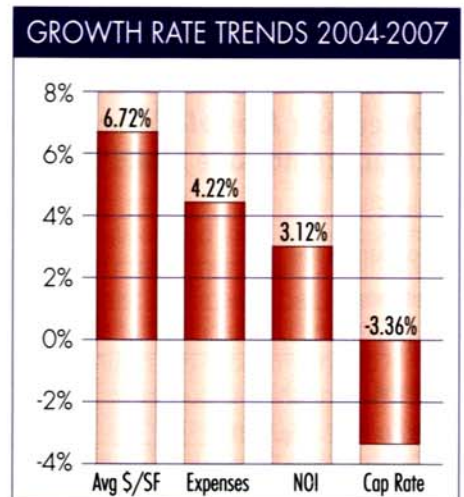
The scope of the survey includes nationwide responses representing 24,421,612 square feet (data gathered by MiniCo, Inc. in connection with the *Self-Storage Almanac* and compiled by the

Self Storage Industry Group of Cushman & Wakefield). The data, collected in the last half of 2007, reflects 2007 year-to-date expense operating information.

The data, collected to serve as a guide or benchmark that can be used as a tool of analysis, is not intended to set an "ideal" standard of operating expenses. The national average data is summarized in Growth Rate Trends: 2004 – 2007. The guide also provides detailed definitions of each account or expense category to assist in standardizing reporting. Therefore, quantitative data such as the *Expense Guidebook* can be a tool for

OPERATING EXPENSES				
Location	Nationwide	Nationwide	Nationwide	Nationwide
Year	2007	2006	2005	2004
Sample Size	492	508	536	509
Area (SF)	24,421,612	24,015,058	17,649,839	n/a
Scenario	Mean \$/SF	Mean \$/SF	Mean \$/SF	Mean \$/SF
Operating Expenses				
Taxes	\$0.55	\$0.59	\$0.68	\$0.44
Insurance	\$0.21	\$0.20	\$0.21	\$0.16
Repairs & Maintenance	\$0.32	\$0.30	\$0.31	\$0.22
Administration	\$0.35	\$0.29	\$0.52	\$0.27
On-Site Management	\$0.93	\$0.68	\$0.97	\$0.74
Off-Site Management	\$0.43	\$0.26	\$0.55	\$0.47
Utilities	\$0.27	\$0.28	\$0.26	\$0.21
Advertising	\$0.35	\$0.37	\$0.27	\$0.23
Miscellaneous	\$0.41	\$0.80	\$0.81	\$0.49
<b>Total Expenses (SF)</b>	<b>\$3.81</b>	<b>\$3.76</b>	<b>\$3.47</b>	<b>\$3.23</b>
<b>Total Expenses (% of EGI)</b>	<b>37.37%</b>	<b>37.62%</b>	<b>44.31%</b>	<b>n/a</b>
% Change / SF	1.33%	8.36%	7.43%	3%
% Change / %	-0.66%	-15.10%	3%	3%

Source: 2007 Expense GuideBook and Cushman & Wakefield's Self Storage Industry Group



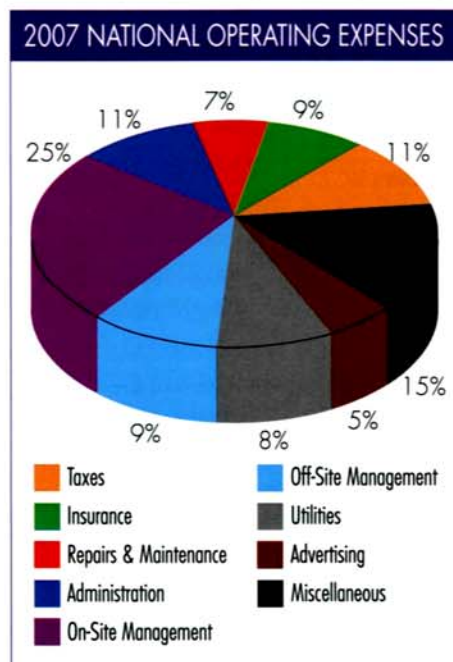
Source: 2007 Expense GuideBook and Cushman & Wakefield's Self Storage Industry Group

market participants to make a reasonable analysis and forecast of self-storage operating expenses.

Management-related expense continue to comprise the largest ratio of overall operating expenses for self-storage. This include on-site management (payroll relates expenses such as salaries and benefits), off-site management (outside management and overhead expenses) and administration (related to office functions such as telephone, postage, and printing).

Altogether, management expenses consist of nearly half (45 percent) of all self-storage operating expenses. Competent management is critical to a successful self-storage business. In a review of hundreds of operating statements each year, management-related expenses continue to be a critical component of a market-based operation (market value or based assumptions include competent management).

After management, real estate taxes are the next largest component, followed by utilities, advertising, and repairs and maintenance. Although self-storage operating expenses can be divided into fixed (taxes and insurance) and variable (all other expenses) components, operating expenses for self-storage tend to be less elastic than in other real estate sectors such as office or apartment property.



Source: 2007 Expense GuideBook and Cushman & Wakefield's Self Storage Industry Group

On the other hand, self-storage does not incur capital expenditures or reserves for replacement because there are no tenant improvements or unit renovations after a tenant leaves.

Most operators tend to manage repairs and maintenance instead of creating a reserve account for large non-operating expenses such as building improvements (such as roof replacement). Therefore, operating expenses tend to be relatively stable, even during an absorption period.

Published for the fourth year in a row, the *Expense Guidebook* data can now be analyzed for trends. As an example, operating expense expressed in terms of dollars per square foot have increased, while the expense ratio (expressed as a percentage of effective gross income or collected income) has decreased. This is consistent with data on net operating income that has shown a pattern of growth consistent with inflation the past four years. This suggests that income levels have increased higher than expenses. Yet, over the past year, a decline in the growth rate of operating expenses suggests operators are tightening budgets and carefully monitoring net operating income.

In the *Expense Guidebook*, the data is reported for the entire country and in five geographic regions. The regional data indicates a range in the average

**OPERATING EXPENSES BY REGION**

National	\$3.81 /sf
Western	\$4.64 /sf
Southeast	\$3.88 /sf
Northeast	\$3.64 /sf
North Central	\$3.59 /sf
South Central	\$3.06 /sf

Source: 2007 Expense GuideBook and Cushman & Wakefield's Self Storage Industry Group

from \$3.06 to \$4.64 per square foot. Not surprisingly, the West region had the highest average. Conversely, the South Central Region indicates the lowest average. Analyzed regionally, the expense data further supports the concept that self-storage is truly a local business. Variances are a function of geographic location, but more particularly are market conditions within a single trade area.

In the past year, advertising operating expenses have declined slightly after two years of substantial gains. This may be a

function of more properties reaching stabilized occupancy. However, anecdotal reports also indicate that it may be a function of reduced reliance on *Yellow Pages* advertising. Some operators are choosing a stronger, less expensive Internet Web page option after stabilization. For properties in urban areas with multiple area codes, *Yellow Pages* advertising can be prohibitive to get into multiple listings.

The data reporting is fragmented as is the industry. Categories such as miscellaneous may be a function of "uncategorized" expense. Therefore, it is important to view total expenses and trends or focus on a single category in a single year. In the *Expense Guidebook*, expenses are analyzed per square foot, as a ratio of collected income and by category.

Among negative economic news and growing concerns of recession, it is likely that operating expenses will grow at a rate near or below inflation. Many are asking about the possible consequences of a recession on self-storage. One theory is that downsizing in the housing market will cause an increase in demand. The alternate theory is that decreased consumer spending in a recession will decrease demand. While the outcome is unknown, it is important to note that national vacancy trends over the last 15 years indicate self-storage is less elastic or responsive to macro-economic conditions. While this may bode well for the future, it is also important to note that self-storage market conditions will vary widely by trade area. Based on operating expenses, it appears operators are spending cautiously.

In weakening economic conditions, good data and analysis are critical to a successful storage operation. Adequate budgeting and expenditures of operating expenses will ensure the long-term viability of a self-storage operation. The *2007 Self-Storage Expense Guidebook*, along with trade area specific analysis, can be great tools to assist in these analyses. ■



R. Christian Sonne is Managing Director of Cushman & Wakefield's Self-storage Industry Group, a nationwide team of appraisal, research, and analysis professionals specializing in self-storage asset class.