

Storage Sector Primps for Uptown Approval

Landlords Are Disguising Facilities in Effort to Expand

By ROBBIE WHELAN

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Just before Christmas last year, a carload of revelers showed up in the lobby of what they thought was a Hilton Garden Inn in Estero, Fla., looking for their company holiday party.

To their surprise, there was no punch and no tinsel. The building was actually a self-storage warehouse. It just didn't look like one because to get city approval, Extra Space Storage Inc., designed the building with gabled, red-tiled roofs, fake windows and ornamental balconies.

The partyers' confusion was understandable, says Spencer Kirk, Extra Space's chief, who heard about the incident from the facility's staff. "It looks like a five-star resort," he says.



Extra Space's self-storage warehouse in Estero, Fla.
Extra Space Storage

Self-storage facilities are springing up around the country amid a supply shortage and strong demand from families, cramped city-dwellers and college students. The growth spurt is the biggest the industry has seen since the downturn and comes as shares of public storage companies are outperforming most other public real-estate companies.

But because of tight restrictions on design, it won't be quick or easy for storage companies to carry out aggressive expansion plans. Local zoning boards and town councils don't like self-storage warehouses because they pay little in property taxes, don't hire many workers and typically are bulky, windowless eyesores.

Landlords are so eager to build self-storage facilities near large, dense population centers—where demand is concentrated—that they are disguising the projects as hotels, office buildings, apartments, stores and other more aesthetically pleasing structures.

Somerville, Mass., recently approved a new warehouse owned and operated by Public Storage, the industry's largest company, only after the design was changed to include a bicycle storage room, green space, a coffee shop and a community meeting room. "A lot of it is about the architecture," says George Proakis, Somerville's director of planning. "If you came in and put up a barn with orange siding and a chain-link fence all around it, that brings down the quality level of what you can put around it."



A Public Storage facility in Hialeah, Fla. *Alamy*

About 16.5 million square feet of new warehouses are expected to be delivered this year, up from 8.9 million in 2012, estimates Shahzeb Zakaria, an analyst who covers the industry for Macquarie Securities. Overall, there are 2.3 billion square feet of self-storage space in the U.S., or roughly 7 square feet for every person in the country.

Most large self-storage companies are structured as real-estate investment trusts, or REITs, meaning they pay out most of their income in the form dividends to investors. As a result, they pay no corporate taxes on that income.

A dearth of new construction in the years after the financial crisis helped push occupancy among the four publicly traded self-storage companies from 85% in 2007 to 92% in the third quarter of 2013. Low vacancy rates and strong profits in the sector made self-storage the best-performing REIT subsector in the third quarter, with a total return of 7.45%, including dividends.

Sovran Self-Storage Inc., which rents under the name Uncle Bob's, posted a total return of 16.8% in the third quarter, making it the best-performing REIT in the U.S. The company is on track to add 360,000 square feet of new space at 33 stores in 2013—more than double the amount it developed in 2010—and has plans to add up to 725,000 square feet in 2014.



Storage spaces tend to be drab. An Extra Space facility in Emeryville, Calif. *Extra Space Storage*

"We are definitely on a building spree for Uncle Bob's," says Rich Pasternak, a construction manager for the company.

Investors have been drawn to the business strategy of the sector. As a general rule, consumers are willing to pay about as much on a per-square-foot basis for self-storage as they pay for a rental apartment, according to Ryan Burke, an analyst with Green Street Advisors. At the same time, self-storage facilities are relatively cheap to build, ranging from roughly \$25 to \$40 a square foot for a one-story facility and from \$42 to \$70 a square foot for a multistory facility, according to Mako Steel, an engineering firm that specializes

in self-storage. By contrast, apartments can cost between \$130 a square foot for simple garden apartments in inexpensive cities to more than \$1,000 a square foot for high-rises in pricier cities, according to Alexander Goldfarb, an analyst at Sandler O'Neill + Partners LP.

Analysts caution, however, that community distaste for warehouses could limit the industry's ability to expand. In Santa Monica, Calif., one self-storage project took 11 years to get the zoning approvals it needed before it finally got built last year. Nearby Pasadena banned the building of new self-storage facilities a decade ago.

While building warehouses disguised as other types of properties has helped win local government approval, it also has added to the cost. This month, Sovran is preparing designs for a new self-storage facility in Somerville that sits next to a 19th-century textile mill. It plans to spend 35% more than usual to build the building in red brick, with decorative arches over the windows to match its older neighbor.

"That one's going to cost a pretty penny when it's approved," Mr. Pasternak says. "But the cost of living is so much higher in Somerville, the rentals we can generate at a facility in that location make it worthwhile for us to spend that money."

For decades, the self-storage industry was dominated by small, mom-and-pop landlords. But in the early 1970s, B. Wayne Hughes, a horse-racing enthusiast from Southern California, founded Public Storage with a facility in San Diego.

Since then, the company has grown into the world's second-largest REIT, with a market capitalization of \$27.5 billion and more than 2,200 facilities world-wide. Mr. Hughes had accumulated a fortune of \$1.95 billion by 2013, according to Forbes.

The number of self-storage facilities has swelled from 6,600 in 1984 to 48,500 in 2012. Since the downturn, companies mostly have grown in the sector by buying warehouses from mom-and-pop operators. But prices have risen as competition has intensified—analysts say recent portfolio sales have traded at yields of as low as 5%, compared with 9% in 2009.

"It's not glamorous," says Dean Jernigan, outgoing chief executive of CubeSmart, one of the large public storage companies. "The only thing sexy about storage is the bottom line."

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