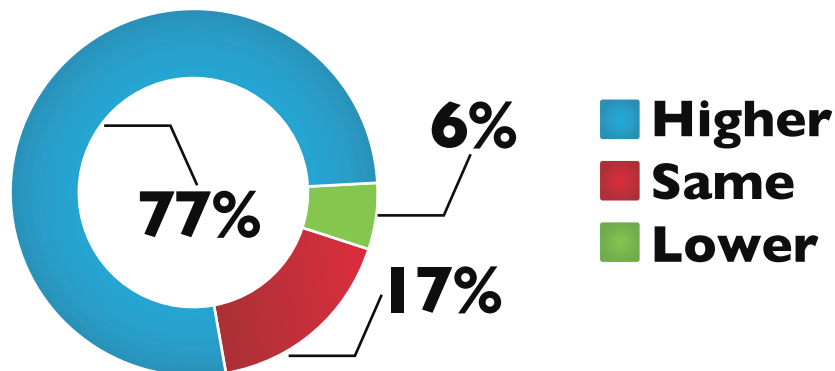


TEXAS REAL ESTATE BUSINESS®

Connecting Real Estate in Texas

Brokers Expect More Business in 2014

Do you expect your firm's total transaction volume in Texas and Oklahoma in 2014 to be higher, lower or the same as in 2013?



SURVEY PARTICIPANTS OPTIMISTIC FOR 2014

In an annual online forecast survey, industry professionals predict growth in the coming year.

By John McCurdy

The results are in, and for the third year running, respondents to the online forecast survey of *Texas Real Estate Business* predict that a year of growth is ahead. Industry professionals including brokers, lenders, developers, managers and owners all see 2014's volumes — whether it's

transactions, loans or new projects — exceeding the levels of 2013.

There's certainly good reason for optimism, as the Texas economy has continued to flourish throughout the year. At the time of this writing, the 6 percent unemployment figure for the state was a full percentage point lower

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SELF STORAGE INVESTORS THINK OUTSIDE THE BOX

With prices in major metro areas rising, secondary markets and value-add options come into play.

By John McCurdy

Boiled down to the basics, self storage properties are simple. Made of metal and generally ranging in size from 20,000 square feet to 90,000 square feet, these structures offer rentable units for those in transition, be it the result of a move, divorce, death or downsizing.

Similarly, the rudiments of owning and operating a self storage asset are straightforward. Customers are attracted by a facility's location, appearance and features and will sign a rental agreement for the right to use their space, just as in any other lease transaction. The management is responsible for maintaining the property and giving the customer that for which they pay.

And yet, despite such seemingly innocuous fundamentals, the investment landscape of the Texas self storage industry is far from uncomplac-



Yellowstone Investment's new development in the Houston suburb of Missouri City, to be branded as LockTite Storage - Premier, will break ground this month. The 1,000-unit property will be located in a retail corridor with Kroger, Target and other prominent stores.

ed. Start with a question as essential as where within the state to build or buy: Which of the four major Texas metros is most attractive?

"They're all very hot," says Bill Bellomy, principal of the Austin-based brokerage of Bellomy & Co. "But another storyline for us over the last 12 to 18 months is that you're also seeing a lot of these secondary and tertiary markets get a lot of interest and activ-

ity because pricing in the core Texas MSAs has gotten so competitive."

Thus, the decision of location will depend upon the entity doing the building or buying, says Bellomy. Investors of a certain caliber will pay — and, in some cases, overpay — for a spot in Dallas/Fort Worth, Houston, San Antonio or Austin. Investors lower on the proverbial totem pole will explore outside those markets.

That, of course, begs the question of which group is more active in Texas. Who are we dealing with here: One of the large, publicly traded self storage REITs, or small operators?

"Well, it's more than just those big players versus the mom-and-pops," explains George McCause, principal of Yellowstone Investments and owner of the LockTite storage brand. "Beneath the REITs are folks that have

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SELF STORAGE INVESTORS THINK OUTSIDE OF THE BOX

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anywhere from 30 to 250 projects. And then, beyond that, there's another very substantial group, could have as few as three properties, that are very savvy and adept at competing with bigger owners."

So, while the "big fish" of Public Storage (236 properties in Texas, according to SNL Financial), Sovran Self Storage (105), CubeSmart (53) and Extra Space Storage (42) have a growing chunk of the existing inventory, they are far from the full story. The majority of properties lie in the hands of smaller ventures, says McCause.

In that case: Are there at least some physical features of a property that will make or break a deal? Security cameras and gates? Ratio of climate-controlled units to non-climate-controlled?

"There are investors and buyers for every single asset class," says Bellomy. "We could have a storage facility with no security cameras, with swinging gate doors, not well built, asphalt driveways — and there's going to be a buyer pool for an asset like that."

A buyer would not be likely to operate such a property without significant capital improvements, of course. But these value-add opportunities certainly exist, says McCause, though they do not trade as often as stabilized projects.

"It all depends," says Bellomy. "It's all in the eye of the beholder."

What Renters Want

While it's obviously difficult to speak in absolutes when it comes to the Texas self storage scene, one trend seems to hold true in most every instance. The specific location — i.e., neighborhood, address and accessibility — within a metro area is crucial.

"It's not that you have to be on the highway, but you have to have a major thoroughfare. You want to be visible," says Brandon Karr, senior asso-

ciate and associate director of Marcus & Millichap's National Self-Storage Group. "These storage locations are really being looked at in a lot of ways like retail locations."

A good example is the 1,000-unit property in the Houston suburb of Missouri City currently under development by Yellowstone Investments. The location, which will be operated under the LockTite Storage brand, is in close proximity to locations of Kroger, Target, Lowe's, Home Depot and several other large stores and restaurants.

Close proximity to the Sam Houston Tollway and State Highway 59 make access easy for customers going about their daily routines.

"Everyone is very concerned with convenience," says McCause. "We find that the better locations are those that are closely related to traffic generators, such as grocery stores and big boxes."

They aren't always easy to come by, but premier spots along crowded corridors come with the added bonus of deterring competition. The more built-up an area is, the harder it is for another self storage facility to pop up in the near vicinity, says Bellomy.

Beyond elbowing into a retail location, properly equipping a facility in terms of security is also a key. Desirable elements include entry keypads and property-wide camera surveillance, whether that means installation during development or — as in the case of the aforementioned fixer-uppers — a new owner implementing these measures after purchase.

Institutional-level buyers will also look for a solid proportion of climate-controlled units and a net rentable area of 60,000 square feet or greater, according to Karr. For instance, in December 2013 Bellomy & Co. brokered the sale of Michener Self Storage in Austin to Lockaway Self Storage, a San Diego-



Michener Self Storage in Austin totals 107,565 rentable square feet. Bill Bellomy of Bellomy & Co. brokered the sale of the facility to a San Diego-based operator.

based owner and operator of 35 properties. The 107,565-square-foot, Class A property offered a healthy mix of climate-controlled and non-climate-controlled units.

Meanwhile, smaller-scale investors are more likely to undertake a renovation or expansion project to overcome any hurdles of size or amenity shortcomings, says McCause. In 2012, his firm Yellowstone purchased what was a Class C property previously operated under the name 620 Minis and overhauled the project into what is now the 55,000-square-foot LockTite Lakeline.

Construction on the Way

The idea that self storage developers and owners can find success by taking a variety of paths is supported by the numbers. In each of the four major metro areas of Texas, the vacancy rate decreased by an average of 6.4 percent from the fourth quarter of 2011 to the end of the third quarter of 2013, according to Reis.

The Houston metro area saw a decline in vacancy of 9.1 percent during that period, from a high of 21.2 percent to just 12.1 percent. With that, all four of the major Texas metros came in below the national average of 12.6 percent vacancy at the end of the third quarter of 2013.

What's more, with the exception of the fourth quarter of 2012 in Austin and San Antonio, the average rent for a 10-by-10 unit increased in every quarter in each of the four MSAs, says Reis. Average rents in Dallas/Fort Worth, Houston, San Antonio and Austin have increased by an average of 9.4 percent since the end of 2011.

It's clear the wide-ranging interest in the sector is not unfounded.

"A lot of real estate owners who had never considered storage as an investment vehicle are looking into it now because they see how steady it is," says Karr, who had closed \$64 million in transactions in 2013 as of press time.

"It's a nice niche play you can make to diversify and meanwhile generate legitimately attractive returns."

As for the specifics on those returns, figures for the majority of assets (those owned by private individuals and investment groups) aren't readily available, but the performance of the publicly traded REITs certainly bodes well. Annual total returns soared from 2007 to 2011, peaking at 35.2 percent, and remained solid at 19.9 percent in 2012, according to NAREIT.

And while the year-to-date returns for 2013 as of press time were a more modest 10.3 percent, according to SNL Financial, the outlook for the industry still remains very positive. So much so that Bellomy sees more projects going skyward in the coming year.

"Specifically in 2014, I think the big story is going to be new construction," he says. "There is so much pent-up demand from nothing being built in 2008, 2009 and 2010. Combine that with the cost of capital being cheap, and that's going to lead to a lot of new development."

Karr agrees, but also offers a caveat. Interest rates are low for the time being for an artificial reason: the Federal Reserve's quantitative easing. Should the decision be made to taper bond purchases — as Karr expects by spring or summer — interest rates will likely rise and attractive loans will be much harder to come by.

That would have a large effect on the acquisitions market, too, as an increase in the cost of capital for buyers and a resultant increase in what are currently historically low cap rates could make both current and prospective owners less enthused to make a deal.

"As such, sellers would be well advised to reach out now and take a look if they're even considering the notion of selling," Karr says. "We've got an opportunity for both sides here, but the window may be closing." ■



Brandon Karr of Marcus & Millichap brokered the sale of this 643-unit self storage property in Fort Worth in 2012.