FEATURED ARTICLE

ADAPTIVE REUSE OF BIG BOX BUILDINGS

By Nicholas J. Malagisi, SIOR

It is no longer, "the best kept secret in Real Estate", according to Jeffrey Shouse, national director of Self Storage Appraisal for Colliers International. In his latest industry newsletter, Shouse states that "comparing overall returns on a 5 and 10 year basis, self storage has outperformed apartments, retail, industrial and office investments…"

While self storage remains a niche asset class among the major property types, more and more institutional money is finding its way into the self storage industry sector. This includes wall street investment bankers, insurance companies, hedge funds, and major retirement funds to name a few. With the exception of multifamily, capitalization rates for stabilized self storage assets are below those of every property sector. One impact of the Great Recession was a stifling of most new development for the past 5 to 6 years.

The "Mom & Pop" developers of the industry are cashing in and being replaced by experienced "Merchant Builders." A Merchant Builder is experienced and well staffed. They understand the development process intimately, they can construct a new project or renovate an existing building, and then either deliver it to an established operator or, stay in the deal as a joint venture partner for some period of time. Merchant Builders no longer have to wait 3 to 4 years for the facility to achieve stabilization to receive a return on their initial capital outlay. They are delivering "Certificate of Occupancy" deals to the publicly traded companies, as well as to larger operators who have access to Capital/Equity partners. With cap rates as low as they are right now and with the larger operators able to shorten the traditional lease up period from 36 to 24 months because of their internet analytics prowess, many Merchant Builders are choosing to sell the completed projects at Certificate of Occupancy (C of O), rather than staying in the deal.

I started my self storage career more than 30 years ago in the corporate real estate department of the industry leader, Public Storage. I began by locating sites for new projects, and working through each aspect of the development process.

Today, I use the same parameters for feasibility analysis. I know how to recognize a good site from a bad one and can make reliable predictions as to whether a project will ultimately be economically viable.

Make no mistake, there is a huge opportunity, in this economy, for experienced SIOR brokers to help their clients re-position existing, non-performing retail or industrial buildings into self storage facilities. Or, in the alternative, to sell the building to a Buyer who can accomplish the Adaptive Reuse of the property into a viable self storage facility.

The properties I am encouraging you to look at may be "functionally obsolete" buildings that can no longer be used for their originally intended purpose. They may be older structures that need to be released from a fund or company that has had a change in corporate direction and no longer has a need for that particular property or location.

While this process of adaptive reuse has been more prevalent in the top tier markets with urban "in-fill" locations, it is now beginning to make sense in the secondary markets (one million people or more), as well. Rather than an outright sale, owners may now have other options for their existing vacant, fully depreciated or underperforming properties. For example, an owner can "contribute" his property to a new joint venture either with an established self storage operator or a Merchant Builders who will redevelop the obsolete building into an income producing asset. The owner of the property can choose to 1) stay in the joint venture until the end of the construction and the JV partner obtains the Certificate of Occupancy; 2) remain in the JV until the property has gone through the lease up phase (2 to 3 years) and stabilizes; or 3) continue in the deal until the next re-financing and/or the sale of the asset at some future date. Many will recognize that this is a savvy estate planning tool for certain investors and families. For corporate America, this is another method of turning a non-performing, excess, real estate inventory into income producing assets.

Keep in mind that we can't take any old industrial building or vacant retail center and redevelop it into a sustainable self storage facility. Recently, I worked on a consulting assignment where I was hired to participate in the evaluation of a portfolio of 350 "industrial" properties owned by a NY Stock Exchange company. My assignment was to determine how many of their company owned properties might qualify for conversion to self storage facilities. At the end of the day, without any study of the competition in the primary trade areas or any consideration of the costs of adaptive reuse, we deemed that only 20 percent of their portfolio might qualify to become self storage properties. Furthermore, upon personal, physical inspection of these properties, we disqualified almost 50 percent of those remaining properties. To

take the next steps the owners will need a professional feasibility study. Broadly, this study will define the Primary Trade Area, study the Supply/Demand characteristics based on the competition and determine the economic feasibility of the adaptive reuse of the project.

Generally speaking, a property of 300,000-400,000 square feet is just as unacceptable as a building that is tucked away in an industrial park with heavy industry or manufacturing. Ideally, self storage requires a site that may be zoned industrial, but has a "retail" presence.

The most obvious retail adaptive re-use example is a closed free-standing Walmart, K-Mart, Target, or Albertson's grocery store that has seen better days. Many of these stores have been replaced in the same or nearby market, with larger, improved, super stores, or perhaps the market has been abandoned entirely. Once deserted, these stores can become an eye sore for a community: graffiti, broken windows, weeds in the asphalt, and all. What better opportunity than this for the self storage developer who recognizes the opportunity to create an in-fill location in a neighborhood that was previously restricted to him, either due to a lack of land, or an available properly-sized structure. If you find such a diamond in the rough, the main building can be converted to climate control units and typical single story, drive up units, may be built on (no longer needed) parking lots. If fact, this past year, a national self storage operator bought a vacant, former auto dealership in Shaker Heights, Ohio. The result was an award winning facility that was recognized in a nation-wide competition for the outstanding conversion/adaptive reuse of the property (see attached photo). Self Storage may not be the first thought on the part of a listing broker with a vacant building, but the talented merchant builder is looking for just these types of opportunities to re-use and re-purpose for self storage. Time to think outside of the box! ∇

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