ANZVGN 11 VALUATION OF SELF STORAGE FACILITIES

1.0 Introduction

1.1 Purpose

The purpose of this Guidance Note is to set out matters to be addressed in the valuation of operating self storage facilities. The items addressed in these notes are in addition to those required by ANZVGN2 Valuations for Mortgage and Loan Security Purposes and IVGN12 Valuation of Specialised Trading Properties.

1.2 Status of Guidance Notes

Guidance Notes are intended to embody recognised 'good practice' and therefore may (although this should not be assumed) provide some professional support if properly applied. While they are not mandatory, it is likely that they will serve as a comparative measure of the level of performance of a Member. They are an integral part of the Valuation and Property Standards Manual.

1.3 Scope of this Guidance Note

This Guidance Note applies to Members involved in the preparation of valuations relating to self storage facilities. It should be used in conjunction with other guidance notes and practice standards which are either over-arching or directly applicable to the issues involved.

1.4 International Valuation Standards

This Guidance Note recognises the International Valuation Standards prepared by the International Valuation Standards Council. This Guidance Note is also intended to be consistent with the concepts and definitions contained in those Standards, however, there may be departures from IVSC Standards to reflect Australian and New Zealand law and practice.

2.0 General Explanation of Self Storage Operations

Self storage operations involve the licensing of storage areas to private and business users for the storage of goods. Storage users may select from a range of storage unit sizes provided within the property.

Self Storage Operators typically apply a standard storage licence agreement and apply a monthly storage fee. Storage fees vary depending on the size and location of the storage unit occupied. Because the licence agreement typically operates on a month to month basis the operator may review the storage licence fee at any time. The frequency and amount of storage fee increases will depend on the management strategy of the operator, the level of competition and storage fees applied in competing facilities.

It is a fundamental element of operation of a self storage facility that the operator does not take care, custody or control of the goods stored. In a limited number of cases operators receive and hold goods on behalf of customers. This requires a specific, modified storage agreement.

It should be noted that the storage industry generally compares pricing levels for individual units on a dollars per month basis.

In addition to direct storage fees, self storage facilities may also derive revenue from late payment charges, cleaning charges when storage units are vacated, sale of storage related merchandise, and sale of insurance for customer goods in storage.

3.0 Instructions and Basis of Valuation

3.1 The Role of the Valuer

The Valuer needs to demonstrate in a report an understanding of the operation of the subject property, the operator's management arrangements, the self storage market place, surrounding competition and any specialised features of the facility.

It is important that the Valuer obtains sufficient detail in relation to the current storage unit configuration, storage unit occupancy, current revenues, operating expenses and arrears status of occupied storage units. It is incumbent upon the party instructing the Valuer to ensure that the Valuer has access to records and information from which the above detail may be extracted.

3.2 Going Concern

The valuation should clearly state that it has been undertaken as a 'going concern' self storage facility on a 'walk in walk out' basis inclusive of all plant, equipment, furniture, fittings and merchandise stock as appropriate.

Going concern valuations are based on the net income associated with the operation of the whole of the self storage activities on the property.

3.3 Facilities Subject to Lease to an Operator

Some self storage facilities are subject to leasehold interests. Valuation of a self storage facility subject to a long term leasehold interest of land and buildings is not a going concern valuation. Valuation of self storage facilities subject to leasehold interests should reflect the net cash flow associated with the lease and the specific terms of the lease.

3.4 Accepting an Instruction

Prior to accepting an instruction, a valuer must be confident of having the necessary expertise and sufficient information to undertake the valuation. For example, if the valuer does not have complete or appropriate access to comparable sales and trading data for the subject self storage facility, then the valuation instruction should be declined, or undertaken in conjunction with a valuer who has the expertise and access to such information.

It is important that the valuer should, as a term of their retainer, ensure the client has an obligation to provide access to records and information concerning the site (as set out in Clause 3.1). It is important that the client and the valuer agree that the valuation cannot be completed until such information is provided.

4.0 Operational Detail

Operational arrangement may vary from facility to facility and there are variations in management and operation arrangements in various regions. Accordingly the valuation should identify and describe the operation arrangements applied in the facility being valued. This would include a description of the following items

- The form of storage agreement utilised,
- Storage unit fee payment arrangements,
- Late payment fee policies,
- Insurance of customers' stored goods,
- Arrangement for the display and sale of merchandise,
- Office operating hours and
- Access hours for existing customers.

5.0 Building Improvements

5.1 Building Construction and Services

The valuer should consider the design characteristics and form of construction of the property, including specialised features that may impact upon the ability to attract self storage customers, viability of operation, and marketability.

The construction, design and general condition of improvements need to be considered in the context of their specialised use, with the following being examples of relevant factors:

- The form of construction and materials used including consideration of the buildings' ability to provide adequate ventilation, insulation against temperature extremes and protection against water penetration;
- The size and mix of storage units, accessibility of storage units including vehicular access, corridor layout and width and lift or hoist systems where multi-level storage is utilised,
- Signage,
- Size, location and appearance of reception and merchandise display areas,
- Onsite caretakers or managers accommodation,
- Customer parking and docking arrangements,
- Access systems including gate access controls and arrangement for after hours access and

- o General site security and unit security including perimeter access control, unit alarms and video monitoring.

5.2 Repair and Condition

The valuation should comment on the state of repair of the improvements of the property, including any outstanding works to be completed and any modification or maintenance work required. Any item that may affect the continuing efficient operation of the self storage facility should be identified.

An annual repair and maintenance expense allowance is a normal item of operating expense and the valuation should include a provision for repair and maintenance as part of normal operating expenses. However it may also be necessary to apply an initial capital expense amount in valuation calculations where building defects present an immediate impediment to continued efficient and competitive operation of a self storage facility.

6.0 Valuation Calculation

6.1 Valuation Methodology

Capitalisation of net operating income is the most commonly applied method in valuation of self storage facilities. Discounted Cash Flow (DCF) analysis is also a very effective and complementary methodology, particularly for substantial self storage facilities. The net operating income should be calculated before depreciation, amortisation, interest, tax and capital expenditure deductions. Such calculations being on a GST exclusive basis.

Experience suggests that the market initially places greater weight on capitalisation (yield) calculations in negotiation of transaction prices. However, informed purchasers and vendors are clearly aware of the variations in net income levels that occur with variations in occupancy. This and other variables are often best displayed in DCF analysis.

The results of both methodologies should be applied in the valuation of larger self storage facilities particularly where occupancy levels may not have reached a full, mature level. Because of the static nature of capitalisation calculations this methodology develops complexities and anomalies when applied to facilities operating at a less than mature occupancy level.

Calculations should demonstrate a transparent connection between actual calculations and current performance levels of the facility. If calculations apply revenue or expense details that vary from actual current amounts there should be a clear explanation and rationale provided for the variations.

An extensive range of operating expenses typically applies in the good management of operating self storage facilities. It is necessary to ensure that complete and realistic expenses are applied in the valuation calculations.

Calculations should display all critical assumptions and inputs, including the capitalisation rate applied. In DCF analysis there is a need to provide a disclosure of other valuation elements including escalation rates, discount rate applied to future revenues and value calculations applied at the end of the assumed investment period.

6.2 Revenue and Trading Performance

The Valuer should clearly establish the current, actual revenue of the facility at the date of valuation. This should be supported by disclosure of elements supporting the actual revenue. This will involve:

- o Identification and description of the total net rentable storage area available.
- o A clear disclosure of the units and unit areas that are occupied and accruing storage fees.
- o Detail of the current actual storage fee rates achieved and accrued (excluding incentives or other distorting factors) for occupied storage areas.
- o Details of other income amounts including such items as late fees, sale of goods in custody insurance, merchandise sales or other areas of incidental revenue.
- o Analyse and make provision for customer delinquency and delinquency write-offs.
- o A month by month history of occupancy level and associated accrued storage fees over time. A 12 month history is generally sufficient to identify any correlation between occupancy and revenue trends.
- o Where available, up to a 3 year trading history is generally sufficient to assist in identifying any correlation between occupancy and revenue trends. If there is less than a 3 year trading history, then a complete trading history will be required.

- o The Valuer should also examine the unit configuration, characteristics and features of the occupied space compared with unoccupied space and where significant variations exist make reasonable adjustment in projected revenues and occupancy to account for the differences.

Accrued and potential storage fee revenue is typically equated to a rate per square metre of occupied space per annum (rate per square metre per month X 12) for analysis and comparison purposes. Analysis of variations in the achieved storage fee rate per square metre will illustrate pricing performance over time. It should also be noted that storage fee revenue rates may be influenced by additions or modifications to the number of storage units or the mix of storage unit sizes.

Where a valuation applies a revenue or occupancy level that differs from the current level being achieved, this should be clearly stated. In these circumstances the Valuer should also state the basis upon which variation in revenue or occupancy will occur including the period over which the Valuer considers these variations will occur.

6.3 Operating Expenses / Outgoings

The valuation should establish the operating expenses applied in the calculations.

Detail of full year operating expenses associated with the normal operation of the facility should be included in the valuation. This should be provided on an itemised basis and include, but not be limited to, advertising costs, site management wages, insurance costs, rates and taxes, bank charges, power costs, telephone charges, merchandise purchases and maintenance costs.

An amount for head management fees should be included in valuation calculations. This amount is in addition to the direct site operating expenses. While this amount is not always incurred as a direct site expense, a management fee would be incurred if the facility were to be purchased and operated on a true investment basis.

The Valuer should critically review operating costs provided, and where it is evident that costs are out of line with industry standard management practices or where significant items have been omitted, the Valuer should make appropriate adjustments to bring costs in-line with industry standards. These adjustments should be clearly disclosed and explained in the valuation report.

6.4 Existing Licence and Management Agreements

It is not uncommon for facilities to operate under management or general branding agreement. The valuation should provide detail of these agreements where applicable including detail of fees and charges applicable under such arrangements. The valuation should clearly state if the assessment is subject to continuation of the Licence or Management Agreement.

6.5 Facility Operator and Customer Agreement

The Valuer should also review the standard terms of the agreement between the facility operator and customer to satisfy themselves that the terms of such agreement are consistent with industry standards and in particular whether the agreement contains clauses which provide that the operator has the appropriate rights to deal with goods left by the customer and that the agreement does not expose the operator to risks that may impact upon running the business.

6.6 Surplus Land / Additional Capacity

It is often the case that self storage facilities have not fully utilised the whole of the site or the whole of the building within which they operate. It is not unreasonable to attribute a value to undeveloped areas within a self storage facility which are not currently income producing or at full income potential. However the value attributed to these areas should be realistically assessed and clearly described in the valuation. Application of revenues based on hypothetical potential does not typically provide a reliable assessment of the current market value. Values based on immediately achievable use are more reliable.

7.0 Competition

The performance of a self storage facility is impacted by the level of competition from other self storage facilities. The Valuer should be conscious of current and proposed competition within the customer catchment area of the self storage facility being valued and where possible discuss the performance of the competing self storage facilities.

Customer catchment areas may vary and are influenced by the position and number of other self storage facilities in the area, transport corridors, natural barriers such as waterways and the demographics and population density of immediately surrounding suburbs.

8.0 Sales Evidence

8.1 Sales Analysis

It is not always possible to obtain sufficient information to fully analyse every sale. However, the Valuer still needs an appropriate level of sales that have been adequately analysed in order to arrive at an opinion of value.

It is not uncommon for self storage facilities to be combined with other uses such as more traditional industrial premises or vacant land. Sales analysis and examination of property yields should identify these varying property uses and make specific adjustments to reflect the component elements.

The sale of 'going concern' self storage facilities typically involves the concurrent and interdependent sale of real property and a sale of a business. Accordingly reliance upon a reported property transfer amount that may be shown in general property data base material can be misleading as it is often only the property component of the transfer that is recorded. In analysis of sale of going concern transactions, it is essential for the Valuer to determine the total consideration paid including both property and business transfer amounts.

8.2 Initial Yield vs. Equivalent Yield

The simplest yield analysis is the calculation of the passing net income (gross revenue less operating expenses) as a percentage of the Purchase Price. This is referred to as the Initial or Passing Yield.

It is however, quite common for self storage facilities to be purchased at occupancy levels that are below a mature occupancy level. This will result in the initial yield being at a relatively low level. In practice, purchasers may pay amounts reflecting the expectation that occupancy levels will increase and there will be a corresponding increase in storage fee revenues and net income. The yield calculated on the basis of expected increased occupancies and associated net income is referred to as an Equivalent Yield[1]. In effect, this is the rate that the Valuer should compare to the adopted capitalisation rate.

9.0 General Issues

9.1 Leasehold Tenure

In cases of self storage facilities held upon leasehold title, the impact of the ground rent on returns/incomes should be fully considered and reflected in the valuation calculations.

9.2 GST Caution

The Valuer should consider the manner in which similar properties are bought and sold from a GST perspective and adopt the most appropriate treatment of GST accordingly. Properties transacted on a 'going concern' basis may be exempt from GST.

9.3 Disclaimer

The Valuer should consider whether the valuation report should contain a qualification concerning the storage of hazardous or illegal goods on the premises and any implications upon value.

10.0 Effective Date

This Guidance Note is effective from 1 January 2011.

[1] Australian Property Institute, 2007, *Glossary of Property Terms*, Deakin ACT.