



Do-It-Yourself Valuation:
It May Not Be As Simple As It Sounds
by Michael L. McCune

Knowing the value of your self storage property is very important to owners who are interested in financing, real estate tax issues, estate valuation, or selling. Appraisal and valuation are a professional art, and while the basic calculations are a very important part of the process, there is also a large measure of real estate judgment and experience in developing a precise value. We cannot impart in this brief article the real estate judgment, but we can give you the basics of the “number crunching mechanics” that may help you arrive at a ball park value for your property. We can also point out some anomalies in valuation that can take you right out of the ball park. Since few of these exceptions are easily understood or usually straightforward to evaluate, we will simply note them and encourage you to seek further advice if they exist in your facility. For the accompanying worksheet that guides you through the valuation calculations, please visit www.argus-selfstorage.com/pdf/value_estimate.pdf.

It should also be noted that a true appraisal takes a much more in-depth look at value, noting not only the value based on income, but value from a Cost Basis and a Market Sales Comparable Basis. The first method compares the cost of replacing the facility in the market to your facility, and the Market Sales Comparable method compares the values actually achieved in the marketplace by similar facilities in recent sales. Without reconciling the values from each of these three independent methods, one cannot be sure that the right value for the property has been identified. It is a complicated process and one that requires expertise and experience of a professional active in the business. Regardless of your need for the information, short cuts to developing the right value can lead you to erroneous conclusions and you must be aware as you follow the steps in this article that the calculations provide merely an estimate of potential value and maybe subject to wide swings in actual values.

With all of the caveats I have stated and the exceptions to be noted hereafter, this article is designed to show you how your cash flow determines, in large measure, the value of a facility and the potential sensitivity of value to various operating results. As you work through the numbers, try changing some numbers like dropping rates 5% or occupancy by 7%, or raise real estate taxes by 20% and see what happens to the values. You will learn why good operations are often the most important factor in creating value. It is important to remember that a buyer determines the price and he is really buying income and not “bricks and sticks.” The Iron Rule of value is: “if there is no income, there is no value and if there is less income, there is less value.”

Rental Income

Since self-storage is a seasonal business, you must take a full 12 months actual experience rather than extrapolating the best three months. An appraiser would also look at the trend over the last few years to see if the trend is declining and, if so, might adjust the final price or capitalization rate. If there is a significant vacancy, say over 15% of potential rents, there may also be an adjustment. Very few appraisers will count revenues in excess of 90% of potential rents, except in very unusual circumstances. When evaluating vacancies it is very important to compare the actual rent received to the potential rent received and not just the physical occupancy. It is very possible to be 92% leased physically and 80% economically occupied. If there are many (or even one) new facilities being built nearby that are about to open or are in lease up, “all bets are off” until it is very clear that rates and occupancies will remain

stable. This is a good place to test the sensitivities by changing the revenue to reflect the potential competition.

Miscellaneous Income

This is the catchall category for late fees, net box sales, truck rental commissions, lock and insurance sales. If this number is more than 10% of the Rental Income, it is possible that a different valuation may be required to properly evaluate this source of income. As this amount grows larger, it may represent “another business” and not miscellaneous real estate income. Such business income is usually valued much lower than real estate income and is often times not counted by appraisers for loan purposes.

Operating Expenses

It is considered a rule of thumb that operating expenses generally run between 30% and 40% with many in the 35% range. If your project falls out of this range, further analysis may be required. The following items describe the expense categories in more detail.

Real Estate Taxes: This looks simple, but it really isn’t because real estate taxes can change dramatically if the property is reassessed. Properties are usually reassessed at time of sale often resulting in a higher tax based on the new price. A buyer will often evaluate the property based on the “new potential” taxes rather than on the actual, which will cause the price he is willing to pay to be lower. Additionally, some taxing jurisdictions may reassess every three to five years, so you must figure out where you are in this cycle and adjust accordingly. If at the end of this exercise you find that the computed value range greatly exceeds the value shown on the tax bill, it is a very good indicator that you may have a problem in the future with increased real estate taxes and thus a lower value.

Salaries & Benefits: This is where the salaries, fringe benefits and employee bonuses are accumulated. If you (or others) work on site but aren’t paid, calculate what it would cost to replace you and add it to the category. These numbers will vary significantly based on facility size and locale. Skip this last step only if you are willing to stay working on the project for free, forever. If you also have some staff that is being paid but not working, deduct their salaries. Don’t include excessive benefits such as very generous pension plans, auto leases, silver plated medical plans or key man life insurance policies.

Insurance: This category should include all costs for property and liability insurance. If you believe that you will be receiving a significant cost increase, use the larger number.

Utilities: This category is relatively straightforward; include costs for electricity, gas, fuel oil, and water.

Maintenance and Repairs: This category should include painting, door repair, asphalt repair, structural and roof repairs and the other things that are routinely repaired during the course of the year. Snow removal and landscaping maintenance may also be put in this category as well as other routine maintenance contracts such as HVAC or pest control. If you have made major capital replacements or additions, delete them. This may include things like a new gate, software, roof replacement, major landscaping or fence replacements. The general rule is if your accountant requires you to capitalize the

expenditure, do not include it here. If your property has excessive deferred maintenance, an adjustment will be deducted in the final valuation to compensate for these items.

Capital Reserves: In order to account for these capital items, an artificial reserve is usually included in the computation of 10 to 15 cents per square foot. This is not an actual expense that will show up on your statement, but rather a number that you should compute and deduct here.

Management Fees: If you pay a management fee to a third party, include it in this category. If you don't, you should add a management fee to your expenses of between 3% and 6% of Gross Revenue depending on size and location of your facilities. This additional expense is necessary because value is based on investment returns and thus must include all management costs for the investment.

Marketing and Advertising: This category includes yellow pages, radio, TV, newspaper and Internet advertising that you have expended.

Office Expenses: This category includes telephone, supplies, software repairs and fees, bank fees and other miscellaneous office expenses. Operating and business licenses can also be entered in this category.

Miscellaneous: This is the category where other necessary but minor expenses are included. Don't include your convention, travel or other personal charges, like lunches or entertainment.

Depreciation: By definition, depreciation is not included in this calculation.

Interest: Do not include interest, as it is not a charge against operating income. However, if you have a loan and it has a prepayment penalty, lock in, or a yield maintenance requirement, see your appraiser or broker as these loans may affect value and marketability significantly. The devil is in the details with regard to loans with these provisions, and they must be reviewed very carefully to determine the nature and magnitude of the impact.

Land and Building Leases Payments: Land leases and building leases usually materially negatively impact value. Because the terms of leases vary as to rent, length of term and other important clauses any generalization is inappropriate and you should confer with a highly qualified appraiser or broker to determine the significance of the lease. Unusual easements on the land can also have a major impact on value, as can nonconforming zoning, flood planes or environmental concerns. Each of these issues deserve very careful analysis and may (usually) impact the values, negating the ranges contemplated in these value calculations.

Net Operating Income

After subtracting the Operating Expenses from the Revenues you now have what is known as Net Operating Income (NOI). This is not Cash Flow as it is sometimes erroneously called. Cash Flow is NOI minus debt service (both principle and interest).

Real estate is often valued by a process of capitalizing the NOI at what real estate professionals call a capitalization rate. The capitalization rate (Cap Rate) is the approximate rate of return that an investor would receive without a loan on the property. Since this is quite a complicated subject we will stick to

the math only. Suffice to say that great properties in great locations have lower Cap Rates and higher prices, while other less desirable properties have higher Cap Rates and thus lower prices. Most properties in today's market sell between a 9 to an 11 Cap Rate. For the characteristics that determine a Cap Rate see our article "[Cap Rates and Sales Prices](#)".

However, for our little math project we will use a 9.5 Cap Rate and an 11.0 Cap Rate, which will define the range for about 80% to 90% of all facilities. To find the estimated value, divide the NOI by .095 and .11 and the resulting numbers will give you a very approximate range of value. Thus if your NOI is \$251,000 the range of value may be between \$2,642,000 and \$2,400,000. Remember, this only applies if all of your assumptions are correct and there are none of the special considerations discussed in this article. You should never price a property based on this analysis, but you should confer with an appraiser or experienced broker, or both! You may either be too low and miss a profit, or too high and not make a sale. Use these value ranges as a general planning tool only. The ultimate value may be influenced by many other factors that are beyond the scope of this exercise such as extra land, excessive overbuilding, deferred maintenance, a changing location preference such as a new freeway to name but a few circumstances. Knowing the math mechanics of value will be useful when talking with a valuation expert, but in the end, as your science teacher said, this may not be something to try alone at home.

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