

7 COSTLY MISTAKES

**MADE BY UNEDUCATED
SELF-STORAGE
INVESTORS**



7 Costly Mistakes Made by Uneducated Self-Storage Investors

The Self-Storage industry is one of the most profitable ways to make money in real estate without the headaches associated with other commercial investments. As a result, many people feel that they don't need any education, they just simply start buying properties. However, there are a lot of things that can go wrong with a self-storage property. When things go wrong with self-storage, they are extremely costly.

Hiring Cheap Labor

One costly mistake that I made was that I allowed my general contractor to hire a cheap excavator. It turned out that the guy was a drunk. He would arrive at the job site and literally fall out of his truck to begin working. I am not sure how that worked since he had to breathe into a tube before he could start his truck. As you can imagine, the drainage was not good, and the drive lanes were soft. So, we had to bring in more gravel and more gravel and more gravel. I later found out that he was unlicensed and working with a tractor and box blade. My beautiful brand new climate control building flooded as a result of the shoddy labor. Don't go with cheap labor, it will cost you more in the long run.

I learned that you must get to know reputable people in the area, especially if you are managing the property from a distance. Be sure to ask for references and do not rely on anyone else to do your hiring. You are better off to hire people who will do a good job that will last even if it costs a little more. Stick with good people, who do a good job, because ultimately, it will be cheaper in the long run.

Trust but Verify

Sometimes you have a feeling. Sometimes things don't look quite right. However, the property manager was able to explain away the issues because I didn't understand the software. It took me a year before I realized that my manager was stealing from me. If you have even the slightest suspicion that your manager is stealing from you, go with your gut. I was lucky. I was talking to a U-Haul employee who was knowledgeable with the WebSelf Storage software. He was able to explain the program to me and then he helped me help track the "inconsistencies." I found out that my manager had been taking money and doctoring the books for over a year. I thought that I could trust him; he had been so good at explaining the inconsistencies to me. Bev Delong said, "Trust but verify, know your software, pay attention – It's your money!" I learned this the hard way. Make sure that you know what is going on with your properties. Make sure that you understand your software. Most importantly, make sure you know your employees.

Always Get Tax Returns

We were buying a Storage Facility from a seller and he showed us a set of quick books that indicated that the occupancy of the unit was 55%. Based on the numbers we moved forward with a purchase contract based on those occupancy rates. The facility looked like something with a nice upside potential that could support itself while we were improving it.

When we asked for tax returns to verify the numbers, he refused claiming that the tax returns also included several apartment complexes and single family rentals. He didn't have a management system like SiteLink or webselfstorage and so we were forced to rely on his Quickbook reports. After closing, we discovered that those reports were a sham. The people who were recorded as paying tenants were not paying at all. He had a bunch of friends and

family members that were using the storage facility for free. However, he listed them as paying customers on the QuickBook Reports. His bookkeeper kept two sets of books. One set of books was to show potential buyers and the other set was for the IRS.

After we purchased the property, his friends and family all moved out. The occupancy rate went from 55% to 29%. I learned two things from this experience. Always demand the tax returns. No matter what!!! If they won't provide tax returns, don't buy the property. When you purchase a property, always expect some friends and family to move out of the property.

Don't Exaggerate the Size of your Self-Storage Units

If you have ever shopped for lumber, then you know that the industry's idea of measuring lumber is a bit peculiar. What we commonly refer to as a 2 by 4 is actually 1.5 inches by 3.5 inches. This is because the wood starts out as 2 inches by 4 inches and then it is milled and planed to give the wood a nice finished look. However, this process whittles the wood down in size. Because of this, people in the lumber world have a "nominal size" and an "actual size" when referring to wood dimensions and consumers are happy.

In the self-storage industry, most 10-by-10 units aren't exactly 10 feet by 10 feet either. The unit sizes can vary for a number of reasons based on the building design, the slab, the wall and door configurations, etc. There isn't a set standard for finished size so every unit may be a few inches off here and there. This generally isn't a big deal, but it can have the potential to cause headaches if you aren't forthright with tenants. What is an approximation? Two inches off? Ten inches off? What about two feet?

In August of 2016, a manager posted that she had received a complaint that the unit which was quoted as being 20 feet by 8 feet was actually only 18 feet by 8 feet. The tenant who

had rented the unit was angry about the missing two feet. Most of the owners and managers that have been involved in the discussion have indicated that their rental agreements include a clause about how the sizes of the units are approximated. However, they also agreed that a two-foot difference was too much.

We have a statement on our addendum that reads: “All unit sizes are approximate and for comparison use only. They are not guaranteed to be exact measurements.” But in our case, we are talking about inches not feet. I think that advertising an 18x8 as a 20x8 is overreaching the approximate size thing. She was losing 16 square feet of space that she thought she was getting. One of the senior members of the forum, Kirkus, wrote, “Just my opinion, but I think several inches is OK. Several feet? Not so much.”

A few of the other Self Storage Talk members said that an acceptable variance in size could be up to six inches. However, anything more than that would need to be advertised and/or priced differently than other similarly sized units. Another senior member, Advantage IT, wrote, “I would agree with a lot of people here. My rule of thumb [is] a 6-inch rule. If it's over 6 inches, it gets rounded up. Under and it's down. Since 97 percent of my units are indeed over 6 inches from approximate size [they are] rounded up. I do have a few units due to the fire walls that are rounded down, giving me some odd sizes. As our managing partner said, ‘Can you still rent them?’ Yes I can, and they rent just as well.”

Self-storage attorney Jeffrey Greenberger has been a voice of caution about which self-storage terminology can get owners and managers into legal trouble. For example, the idea of climate control can be a murky one. Are the units heated and cooled or are they temperature and humidity controlled? Other problem areas related to how operators market their security features or how you advertise the use of a free rental truck. You can even get into trouble when you use

the word “professional” to describe your services. Make sure that you talk to your attorney before you advertise your services so that you are protected.

There are some people who will look for any excuse to complain or even worse, sue. If you don't think that unit size is something that tenants will take you to court over, you are wrong. A long time tenant recently sued her operator because her unit was larger than what she was originally told. It isn't my property and so I don't remember exactly, but I believe that the unit was supposed to be 300 square feet. Self Storage Talk Moderator MamaDuke said, “She actually had about 450 square feet, so [she] got about 150 [square feet] free every month for about 10 years. But she was irate when she measured at move-out and found it to be different than the contract. Yes, she really did take us to court over it!” Of course, the tenant lost, but who wants to be taken to court over frivolous nonsense.

This isn't just an issue in the United States. In July of 2016, a self-storage employee in Hong Kong was arrested for allegedly violating the city's Trade Descriptions Ordinance, which prohibits businesses from presenting false or misleading statements to customers about products and services. She was accused of exaggerating the size of smaller units in her facility. An undercover agent reported that her units were actually 20 percent smaller than she was advertising. The penalty in Hong Kong for false advertising is five years in prison and a HK\$500,000 fine.

While the United States is not nearly as strict on false advertising, the intent to defraud or mislead is a misdemeanor that can carry a maximum penalty of six months in prison and a fine up to \$5,000. Repeat convictions double the penalty according to Cornell University Law School.

If you think about it, the way that we market unit size is a bit of a misnomer to begin with since tenants are really renting cubic feet not square feet. But it is generally easier for people to understand that they are renting 100 square feet instead of 1000 cubic feet. This is why it is important to have showroom units that customers can see to gauge what size they need. Some showrooms don't have enough space, but if you do, having moveable walls where you can adjust them to the size of the unit can help managers show prospective renters exactly the size of the unit they will be renting.

Now we are not likely to see a rash of lawsuits based on inaccurate self-storage unit sizes, but knowing how much of a discrepancy there is between the size of the unit you are advertising and the size you are actually renting is important to managing risk. If you are not sure of your unit sizes, go measure them. That way you won't have a two foot surprise that is just waiting for a tenant to discover it. You should also discuss with your attorney how much leeway there should be between the sizes that you quote and the actual size of the unit that you are renting. Make sure that your rental agreements protect your business according to what your attorney says.

Always make sure that you are selling the right unit at an auction

In late October, the Illinois Court of Appeals released its decision in Vartik Dubey vs Public Storage Inc. This was a harsh verdict against the self-storage industry for the wrongful sale of goods. I am not personally involved in this case and the facts that I am citing are those that are delivered in the decision. I don't know if Public Storage plans to appeal the case to a higher court. However, the decision is worth noting.

Here is a quick recap. Ms. Dubey rented a unit at a Public Storage facility in Illinois and at the time told the employee that she had a large amount of items that she needed to store: a washer, dryer, refrigerator, bikes, lawnmowers, televisions, jewelry, basketball hoop, etc. She chose the larger of the two units she was shown and agreed to come back later and sign the rental agreement. The manager prepared the rental agreement for unit C-10 and Dubey signed it. The manager took her to her unit and placed her lock on it. A few days later, the tenant began to move in.

Unfortunately, the unit that the manager placed the lock on was E-11 not C-10. E-11 had been rented to someone else who subsequently failed to pay rent. Public Storage sold the contents of E-11 – Dubey’s property. Dubey was on automatic payment via credit card and was not delinquent at the time her belongings were sold. When Dubey discovered that she could no longer access her unit, she went to the management for an explanation. The manager explained that the unit had been sold to recoup the \$191 past-due balance and that the items of a personal nature that could not be sold, photos for example, had been thrown out. The manager refused to even tell Dubey where the garbage was so that she could attempt to retrieve her items.

Assessing the damage: Dubey claimed that her goods were wrongfully sold and that she was given no notice of the sale. She also claimed that she was storing \$150,000 worth of goods even though the rental agreement she signed had a provision limiting the value of personal property stored to \$5,000. She also testified that the rental agreement was only explained to her for five minutes, the unit number was not clearly disclosed, and that she was not informed of the value limit.

The case was tried partially by a jury and partially by the court. The verdict in Dubey’s favor was \$5,000 for breach of contract and \$5,000 for conversion. The Jury also awarded

punitive damages in the amount of \$745,000. (this amount has been remanded for reconsideration.) The trial court handling the Consumer Fraud Act claim awarded compensatory damages of \$69,145, an additional punitive-damage award of \$207,435, plus attorney's fees of \$185,849, bringing the wrongful-sale verdict total to \$1.217 million, upheld by the Court of Appeals.

There are two things that you need to take away from this case. First value limits in a rental agreement should be highlighted or bolded and pointed out to tenants. You can even have tenants initial this section to verify that they were properly explained to the tenants. Also, make sure that you include language in your agreement that higher value limitations may be available for consideration if requested. This is mandatory in New York and recommended in light of several other cases on the subject.

The courts were very concerned with a \$5,000 limit on a large unit. As operators, you need to think about whether it is appropriate to have ascending value limits based on the size of the unit. You could perhaps limit smaller units to \$2,500 for smaller than 100 square feet and \$5,000 for 200 or less square feet and then have higher limits for larger units.

The second thing that you need to take away from this case is that the Public Storage had no remorse and did nothing to help Dubey retrieve her sentimental items once they learned of their mistake. Public Storage never seemed to admit that there was a wrongful sale. The company also had no policy or procedure in place to make sure that they were selling the right unit. They were not willing to help her once the mistake was pointed out to them.

If you discover that you committed a wrongful sale, sticking your head in the sand is the wrong thing to do. Make sure that you show appropriate amounts of remorse and try to assist the

tenant in recovering any items that were sold. Helping Dubey find her personal property may not have averted a wrongful-sale verdict, but it certainly could have taken the wind out of the sails in upholding punitive damages.

Zoning and City Ordinances: Make sure that you are aware of what you can do with your property before you purchase it. The city may not see things the way you do.

In Quebec, Canada, the city instructed Barrette & Associés to seek a court order against a Self-Storage Operator because of multiple violations of municipal regulations. “In both cases, the problem is particularly linked to external storage banned or made in contravention of the regulations,” City Clerk Jean St-Antoine told the source. The self-storage owner Colin Keillar had been in dispute with the city for three years over whether or not he can store storage containers on the front of his property.

“We have a difference of opinion,” he told the source. “It’s the storage in the yard that they don’t like. Originally, they sent me a [notice] that there is a bylaw that says you are not allowed to have anything in the yard in front of the building. The thing is my building was built 40 years ago in the back of the [property]. Under new regulations, the building has to be built in [the] front of the yard. It was all legal back then (when it was built).”

A letter from a city inspector advised Keillar that he couldn’t have storage containers in the 300 feet of yard space in front of the building. “What am I supposed to do, turn it into a dog park? That’s how it all started,” he said. “The whole yard is in front. There’s only 30 feet behind the building on my property.”

They are also contending that the 20 decommissioned U-Haul trucks on the property constitute scrap and must be removed and his fencing must be fixed. While he is in the process

of attempting to fix these complaints, Keillar contends that it is too costly to renovate under the current city codes and he believes that his property should be grandfathered in based on the date it was built.

Make sure that when you are purchasing a property, the seller is compliant with current city codes. You don't want to find yourself in a situation where you believe that you can do one thing with the property only to find out later that you can only use your land for a dog park.

Safety is Critical

A Self-storage operator in North Bay, Ontario, Canada was fined \$100,000 on January 29 because a person visiting the property fell through an open hole and died from their injuries. The Court also imposed a 25% victim fine surcharge. The property was once part of the Aerospace Defense Command Defense system. Seavale was in the process of converting the 28 silos into self-storage buildings. According to a source, "an opening, measuring approximately 4 by 10 feet, was left at the rear of each building. [The opening was] Framed for the later addition of stairs to the basement, the holes weren't protected by a guardrail or covering."

The facility was not thoroughly fixed which resulted in the death of a visitor. If you are renovating a property, you need to make sure that there are no obvious hazards that a tenant or employee might encounter. You don't want to risk the health of anyone who is visiting your property.

When you are investing in self-storage facilities, make sure that you think about these 7 mistakes so that you don't get fined or caught up in expensive litigation. There are a lot of details to remember when you are a self-storage operator and some of them are easy to miss when you don't have the training or experience that you need to prevent costly mistakes.