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Thinking Outside the Stocks

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By M.P. MCQUEEN

There is always a bull market somewhere. With the stock market continuing to whipsaw and bonds getting ever-pricier, investors are looking further afield for decent returns—and some are finding them.

Self-storage buildings, anyone? How about abandoned railroad beds, cellular towers, student apartments or parking facilities? Such unglamorous niches, once shunned by the investing elite, are performing well in 2010, even as the Dow industrials limp along.



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Andrew Spear for The Wall Street Journal

Brent Hayes of Athens County, Ohio, has made big profits by purchasing abandoned railbeds and reselling the land.

If you haven't heard about these seemingly arcane plays yet, it may be because the smarter money is getting there first. In some cases, private-equity firms, pensions and college endowments, which are cutting their exposure to stocks, are looking into these and other offbeat investments.

Just ask Ken Nitzberg, chairman and chief executive of Devon Self Storage Holdings LLC in Emeryville, Calif. He says he is fielding more calls from investor groups, and has partnered with institutional investors including the State of Michigan Retirement System and Goldman Sachs Whitehall Funds. He also

manages properties for college endowments and high-net-worth families.

Mr. Nitzberg says he got into self-storage in 1993. Initially, "we looked down our noses at it," he says. But after his first venture—the conversion of a strip mall into a self-storage facility—produced a solid return, he was hooked. Since then, while other investors fixated on stocks or more upscale real-estate projects, Mr. Nitzberg has focused on storage. He says the company now owns or operates 48 facilities in 12 states.

Mr. Nitzberg says many of his properties are producing annual returns of 8% to 10%, and a few are exceeding 15%, "which in a 3% Treasury world is pretty good."

Investing in storage facilities or parking lots is far harder than, say, trading stocks via an online account. Not only can they be as risky as any other investment—they also tend to be highly illiquid. Buy a property imprudently or manage it poorly and you run the risk of price depreciation, high vacancy rates, property damage or interest-rate jumps on loans—any of which can sink your returns.

In general, these offbeat commercial-real-estate ventures should be viewed as long-term holdings, not short-term flips—and as alternatives to dividend-paying stocks and bonds.

But for income-oriented investors willing to put in the leg work, these properties can generate annual returns of 5% to 9%, say experts. In some cases, they also confer tax advantages.



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The following examples won't make sense for everyone—but they might help you look at other everyday investment possibilities in a new light:

Alternate Universe

As investors step up the search for lower-risk, higher-return opportunities, more are turning to areas of the commercial-real-estate world that would have been considered "fringe" a few years ago.



Associated Press

Student Housing: REITs and private investors are scouting out big apartment complexes close to universities. They can generate 7% to 9% annual returns with lower risk than other apartments because parents co-sign the leases.

• **Student housing.** The economy may be cyclical, but "kids are always going to school and parents are going to continue to pay for it," says Peter Katz, senior vice president of investments, national student housing group, at Marcus & Millichap Real Estate Investment Services. That, he says, is what makes this niche of the multifamily housing market somewhat recession-resistant.

"Purpose built" student-housing developments are basically off-campus apartment complexes. They are a relatively recent phenomenon, with most having been built in the past 15 years, and primarily in the South and Southwest.

Student housing can be less risky than apartments because parents are usually co-guarantors, reducing the chances of getting stuck with the bill if a student drops out and skips town. Some owners even require a parent's credit-card number.

"A lot of new money has come into the sector" in the last 24 to 36 months, says James Tramuto, executive vice president in the real-estate investment-banking practice at Jones Lang LaSalle's offices in Houston.

There are risks, of course. The biggest: oversupply resulting from a drop in enrollment or a building spike, which could increase vacancies and reduce rents. Student housing also tends to carry higher management and maintenance costs. Those off-campus keggers can do serious damage to stairwells, carpeting and drywall.

As with other multifamily properties, older student developments tend to have more upside potential than newer ones because owners can renovate them and boost rents, Mr. Katz says. Such properties can yield 7% to 9% annually, say experts.

Investors can play student housing in several ways. Wealthier folks can develop projects themselves, or join partnerships, and can obtain financing through Fannie Mae and Freddie Mac for up to 75% of the property value.

Smaller investors can buy publicly traded real-estate investment trusts that focus on the subsector, including American Campus Communities Inc. and Education Realty Trust Inc. The latter has produced a total return of 50% this year through Sept. 1, while American Campus has gained 12.5%, compared with a 0.9% drop for the S&P 500, according to investment-research firm Morningstar Inc.

REITs are much more liquid than individual properties because they trade on exchanges like stocks. But they also tend to carry high expenses, and their tax treatment isn't great: A portion of their dividends is taxed as

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Associated Press

Self-Storage Facilities: One of the fastest-growing sectors of commercial real estate, these low-maintenance properties can generate annual returns of 9%, or more in some locations.



Bloomberg

Cell-Tower Leases: Owners of well-situated properties can extract additional income by leasing land or roof space to wireless companies for cellphone antennae. Leases generally range from \$300 to \$3,000 a month, per antenna.



Reuters

Parking Lots: Annual returns of 6% to 8% are possible, and the land can be converted to higher-yielding properties in the future. Also: Owners can raise rates on short notice, making the investment a good inflation hedge.



Andrew Spear for The Wall Street Journal

Railroad Rights-of-Way: There could be more than 100,000 miles of old railway in the U.S., much of it abandoned and selling cheaply. The land is often ripe for future development.

ordinary income, and they are ineligible for the depreciation deduction for real property.

Small investors can also buy or build single- or multifamily homes near colleges. Real-estate investor Ryan Hinricher says he and partners in 2005 built four rental homes in Memphis, Tenn., close to the University of Tennessee Medical School and a U.S. Navy support facility. He says he paid \$185,000 to \$190,000 per property, and they are yielding about 10% a year.

Home prices since have dropped about 18% in the area, he says, "but we invest for

income, so we are not betting for prices to rise in a two- or three-year time horizon."

• **Railroad rights-of-way.** Is there gold in them there railbeds?

Brent Hayes thought so. Mr. Hayes says he has amassed a fortune of more than \$17 million in part by buying abandoned rail lines from CSX Corp.

He started his career in the construction business and now specializes in developing distressed properties. In the early 1990s he purchased about 20 miles of abandoned railroad, or 106 acres, near Athens, Ohio, for about \$135,000. The draw: its "aggregate," or the crushed rock and gravel between rail ties, which he used in his construction business.

But once he removed the rails and cross-ties, he says, he discovered that the surrounding land was worth much more because of improved access. He began selling off parcels to property owners, and kept some for development. He says the Ohio Department of Transportation paid more than \$200,000 for seven miles of right-of-way to widen a highway. He also sold off easements for a natural-gas line.

"It was one of the best investments we ever made," he says.

The success enabled him to get bank financing for more acquisitions. Since that first purchase, he has bought about 300 more acres of abandoned railroad rights-of-way, paying about \$385,000 all told. Mr. Hayes says he sold one parcel to developers of a medical office building, and another for a Super 8 Motel, among other projects.

There are plenty of other opportunities to buy abandoned railways. Greg Harrison, a software engineer and railroad buff in Fort Worth, Texas, maintains a website, Abandoned Rails.com, that tracks properties.

Purchasing abandoned rail property can be difficult. Investors need to know the area well, and must track down the entity that holds the title, often the real-estate department of a successor company to a defunct railroad. Mr. Hayes says he made dozens of phone calls before locating a CSX official in Jacksonville, Fla., who could authorize the first sale.

In addition, environmental cleanup work may be necessary, because of diesel fuel or other contamination.

• **Cell-tower leases.** Smartphone mania could be presenting opportunities in real estate. Investors who are sizing up commercial properties should also consider their potential as cellphone antennae locations.

Owners of buildings and hilltop land near interstate highways or on corners in densely populated areas can sometimes squeeze out extra income by leasing the right to cellular companies to erect cell towers on their premises.

Having an eligible property is a "little like winning the lottery," says Neil S. Levinbook, a New York attorney who specializes in negotiating cell-tower and antenna leases. Monthly rents on the nation's nearly 250,000 towers run up to \$3,000 per month, he says, depending on the property. In the best locations, several companies may rent at the same site, says Mr. Levinbook, whose law firm is affiliated with Steel in the Air Inc., a cellphone-tower consulting firm.

In most cases, the wireless companies approach landowners directly, but people also can apply for consideration through the companies' websites.

But be warned: The towers cause additional liabilities and obligations for landlords, including insurance for property damage or personal injury. Another drawback: lease-contract clauses generally give cell-phone companies the right to terminate agreements with just 30 to 90 days notice. Towers also are politically controversial in many communities.

• **Parking lots and parking meters.** Though the market is highly fragmented, and properties aren't frequently traded, this arcane segment of commercial real-estate is receiving increased attention from private investment groups. Last year, for example, a group led by Morgan Stanley Infrastructure Partners paid \$1.15 billion for the rights to maintain and manage Chicago's 36,000 meters for 75 years.

The draw? Annual returns for parking lots can be in the 6% to 8% range or more, says Robert Caplin, executive vice president of Next Parking LLC in Northbrook, Ill., which owns and operates facilities in seven states.

Parking facilities carry other advantages: Owners have the ability to raise rates on short notice (a good hedge against inflation); there is no significant cost to replace tenants; and owners can develop the property into something else if better opportunities arise.

But there are downsides, too. While banks will lend money for parking lot projects, they typically require a 40% down payment. Maintenance and insurance costs can be high. And struggling state and local governments are raising real-estate taxes, which are already high.

• **Self-storage facilities.** Believe it or not, almost one in 10 U.S. families rents a storage unit, according to the Self Storage Association, a trade group, up from 1 in 17 in 1995. Near military bases, the demand for space is even greater: military folks can occupy from 20% to 95% of nearby storage units, the association says.

All told, last year there were more than 50,000 public storage facilities across the U.S., with \$22 billion in sales.

Costs, meanwhile, are lower than other types of commercial property. Self-storage facilities tend to require a handful of employees and need minimal maintenance. Property taxes, utilities and insurance are the largest expenses.

Another plus: tax treatment. Owners can depreciate their costs, so cash flow after covering operating costs and debt service often doesn't result in tax liability in the early years of ownership.

The self-storage subsector usually holds up well in recessions. While some people cancel their small-unit leases to save money, sales from bigger units often jump as people who move in with friends or relatives or downsize their homes lease more space to store their belongings.

The latest recession has been tougher on the industry than usual. Stubbornly high unemployment has caused more storage renters to terminate or default on their leases, owners and managers say.

Still, occupancy rates have remained fairly strong, particularly in the Northeast and Mid-Atlantic states, according to Marcus & Millichap, the real-estate investment services company. Rents are rising in some metro areas in the eastern U.S., such as Baltimore and Washington, and even in some Midwestern cities, including Indianapolis, Cleveland and Columbus, Ohio, according to Millichap.

"There are good opportunities for buyers right now," says Charles LeClaire, senior vice president at Millichap. The firm forecasts capitalization rates, or potential return rates, in the 8.5% to 9% range through the end of 2010.

The main risk? Barriers to new competition are low, and new rivals can drive down rents in some markets.

Smaller investors can buy mom-and-pop type self-storage units in small towns and cities for \$400,000 to \$1.5 million through local brokers, Mr. LeClaire says. Big investors, meanwhile, often participate through limited partnerships and private-equity funds. Typically the minimum investment in such arrangements is \$2 million.

There also are publicly traded real-estate investment trusts that are big players in the field, including [Extra Space Storage Inc.](#), [Public Storage](#) and [Sovran Self Storage Inc.](#) Year to date, they have generated total returns of 40.1%, 25.3% and 13%, respectively, according to Morningstar.

But self-storage is one commercial-real-estate play that smaller investors can make by themselves. "It is a pretty basic business with not many capital expenditures," says Alan B. Lancz, an investment adviser and real estate investor in Toledo, Ohio. "It is amazing how many people keep paying for units year after year."

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