

PARKING CASH IN NICHE PROPERTIES

Parking properties offer investors diversification, steady income and a chance at handsome appreciation.

Robert Caplin

We have all circled the same city block, searching for the highly coveted and elusive legal parking space. In Chicago, and in many other cities, finding on-street parking in the central business district (CBD) can be a maddening proposition and a virtual impossibility. But, this dilemma also provides clues to the often-overlooked potential of parking properties as real estate investments. This under-followed, unloved and misunderstood niche real estate opportunity offers a host of advantages and potentially lucrative returns.

HISTORY OF PRIVATE OWNERSHIP

The paid parking industry in Chicago has traditionally been pioneered and dominated by closely held private firms. In Chicago, two of the most prominent players in this arena were the Prussian Family and the Warshauer Family, both of which are presently large national owner/operators of paid parking facilities.

For many years, these family-run businesses controlled choice urban sites that were developed into surface lots and parking structures that could generate significant cash flow with minimal operating expense. There was little need to invest in technology or streamline operations. The garages served a basic need, and owners had no incentive to do anything more than minimal maintenance. As a result, the image of dark, dirty, uninviting and sometimes dangerous parking garages lingers today.

Parking properties are still largely in the realm of private entities, although not exclusively. With the exception of several large national parking companies — most of which were formed through mergers or acquisitions of small private operators — large institutional investors continue to shy away from parking properties as investments. Many parking facilities are too small to be considered by the insurance companies and pension fund behemoths looking to place \$100 million in marquee trophy assets. The lack of understanding among lenders, the absence of anchor tenants in most parking properties, and the nuances from the operating side of the business have conspired to keep these assets from becoming mainstream. Neverthe-

less, this has created opportunity for private investors and other entrepreneurial buyers looking to diversify into this niche.

NATURAL BARRIERS TO ENTRY — GOOD NEWS FOR INVESTORS

In Chicago, and in most dense metropolitan areas, there are certain macro trends and natural barriers to entry that inherently limit competition. Consider the most obvious: the declining number of on- and off-street parking spaces.

In Chicago, the number of surface parking lots in the downtown West Loop, once a haven of inexpensive options for those willing to walk a few extra blocks, has begun to shrink. The new ABN AMRO corporate headquarters at 540 W. Madison St. is just one high-profile example of how new development is eliminating parking options in the CBD. Continued development of prime River North and Greek Town parcels is also steadily reducing parking options around town. Although the reduction in parking spaces signals more frustration and higher costs for consumers driving downtown, it also points to rising income streams for parking properties.

Zoning trends also provide a favorable backdrop. In Chicago, the rewrite of the antiquated zoning code, in conjunction with the latest version of the Central Area Plan, is being designed to keep vehicular traffic to the perimeter of the Loop. It now has become difficult, both financially and politically, to build a new parking structure in the Loop. Mayor Richard Daley and city planners have no incentive to add inexpensive parking options that would increase traffic downtown. Parking rates are clearly headed higher, and this is good news for parking facility owners and investors.

Another key benefit for the parking asset investor is the ability to react to the market instantly. Parking contracts are usually of a short-term nature, often never trending out beyond 30 days, so any rate change will affect the owner's cash stream immediately. The nature of these parking contracts also mitigates risk. If the parking operator overestimates what customers are willing to pay,

these rates can be quickly adjusted to find the right pricing structure. Fundamentally, the market for parking is a simple and visible function of supply and demand.

CONSTANT MONITORING REQUIRED

As with any investment that offers upside potential, there are also significant challenges involved with parking properties. Financing purchases can be difficult because many lenders do not fully understand the business. Unlike other asset classes, most parking properties cannot rely on anchor tenants to provide security in the traditional sense. The short-term nature of parking contracts also necessitates continual marketing and monitoring of the market. Are your rates competitive? Is your asset underused at certain periods? Either the owner or the manager must be willing to be involved in day-to-day operations.

Another challenge comes from spiraling parking and real estate taxes, which typically are the largest expense items associated with these assets. Taxes can rise dramatically on short notice, and there are no pass-throughs as with retail properties. With municipalities everywhere facing budget shortfalls, it is unlikely that tax rates will decline any time soon.

Public works projects can also provide unforeseen disruptions in income. In Chicago, the Wacker Drive reconstruction during the past several years re-routed traffic numerous times and hampered operations at several parking properties. Scaffolding from private development projects can also obstruct signage and have a material impact on monthly receipts. Disruptive corporate events — such as a relocation or bankruptcy — are virtually impossible to account for in any risk analysis. And finally, one of the most notorious issues for parking lot investors is employee theft. These impediments have conspired to keep most conventional real estate investors away from parking properties. However, those who are willing to address the challenges also have the potential for reward. In Chicago, where the macro trends favor ownership and the diversified economy provides a viable draw to



Next Realty owns the parking garage at 60 E. Lake in Chicago.

the Loop, the downside is limited. Owners willing to reinvest in aging properties and streamline operations can reap further gains.

FROM UNDERUSED TO PROFITABLE

Buying an underused parking asset in a high density neighborhood is an excellent option for diversifying any commercial real estate portfolio. With a sound strategy, these properties can generate annuity-like cash flow. They also offer a natural hedge against inflation, considering that parking rates in Chicago have increased approximately 7 percent annually in the past decade. Total returns on paid parking investment can be significant even with today's cap rates at about 7 percent.

Given the current low interest rate environment, the natural barriers to entry and the attractive yields, these properties are an excellent place to park money while investors wait for alternate land use. Furthermore, this natural income play also offers potential above-average returns as land values rise and redevelopment of the site becomes a viable option. When the development cycle turns and builders consider their options, they call owners of parking garages first. □

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