



SELF STORAGE SALES NETWORK

Market Monitor

"America's Premier Self Storage Brokers"

Issue IX-2009

Self Storage Owners Have A Lot to be Thankful For

by Michael L. McCune

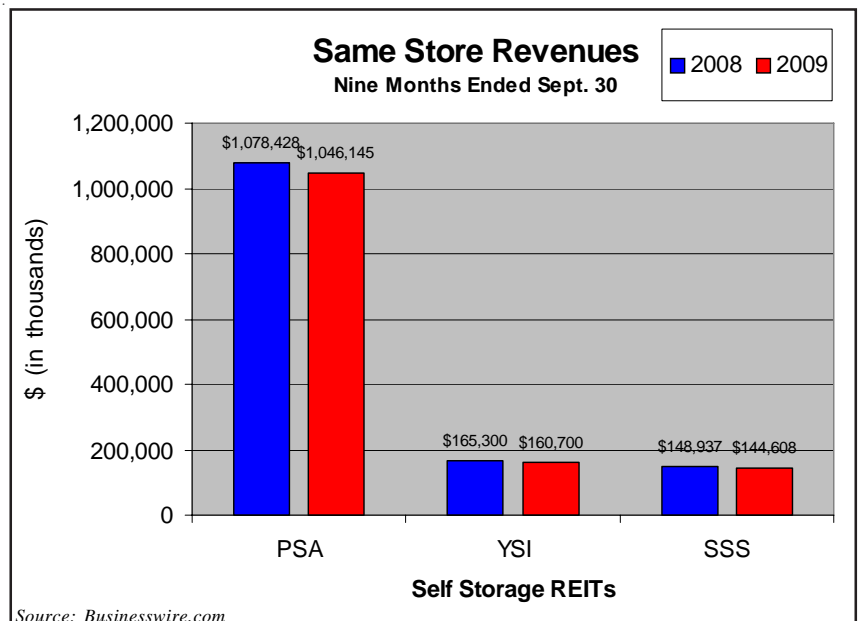
You may recall that at this time last year, the Secretary of the Treasury was on his knees begging Congress for TARP money, and essentially telling congressional leaders that the sky was falling and only the better part of a trillion dollars would cure the problem. Never mind that they didn't spend the money on what they said they were going to spend it on. In the ensuing months, the downward slope of the economy increased dramatically. Banks were going bust (or should have), loans were impossible to get, home mortgages were being foreclosed left and right, stocks were dropping like a rock and asset values were essentially cut in half or even more. Consumers quit spending and decided the old car would run for another 50,000 miles. CEOs were cutting employees by the droves (but not their own bonuses), and thus more home mortgages went unpaid. In short, everybody was seriously scared and should have been!

In the commercial real estate (CRE) markets, liquidity (i.e. loan availability) completely dried up causing buyers to disappear and sellers to freeze in place. Goldman Sachs was suggesting that cap rates would go up (values go down) by 300 to 500 basis points. It looked pretty bleak for CRE markets, and for several months transactions were almost nonexistent. REITs found that they were out of money and a lot of their mortgages were coming due causing some to go into bankruptcy. Several real estate experts have calculated that office building and hotel values have declined on average 50%, with the other classes of CRE not being far behind. It really has been a long, slow, scary year.

A wise man once said that "there must be a pony in here somewhere." Sure enough, there is a pony in there and it is self storage properties. While self storage has not been entirely immune from the effects of the recession, the colossal devastation that has visited other types of real estate has been less damaging for self storage properties. This isn't because of luck; it is because of natural, positive differences in the way that self storage works as a business.

We follow the REITs quite closely because the SEC makes them publish their audited results on a quarterly basis. Since the REITs have a broad distribution and large number of stores, this information provides us with a reliable gauge of what the entire market is doing.

In the chart below, we have compared the quarterly results of the REITs for the last year and found that their same store revenues from 2008 to 2009 have only declined by about 2.7% to 3%. By orders of magnitude, these results are better than what other categories of real estate experienced and while it is somewhat painful, it certainly is not devastating to self storage operators.



However, to look at an even more positive aspect of these numbers, let me run through some math with you. Just for the sake of argument, let's say that the average tenant stays a year. Thus, if in the last year the occupancies only declined by 10%, it means that on average, 90% of the current tenants were NEW clients during the year! This statistic says something very good about the self storage product and the strong demand and need for it. Trust me, this is not a claim that any other CRE class can make about their consistent demand, especially in the worst recession in nearly 80 years! As you review the chart of Same Store sales for the major REITs, I think you will agree that given any market these numbers are quite impressive!

Every other type of CRE spends huge amounts of money to acquire new tenants. Office landlords incur brokerage fees and remodeling costs, while retail, industrial and hotels have their own unique, but very expensive ways of acquiring tenants. Self storage seldom requires large capital expenditures of any nature and very seldom does an empty unit require material refurbishing after a tenant moves out. The apartment landlord

(continued)

can only dream of this situation as he repaints and buys new refrigerators and carpet as his tenants move out.

Most importantly, self storage leases are usually thirty day contracts. This allows the owner the ability to adjust the rents at any time and react quickly to changes in the market. The rent increases can be as frequent as the owner wants and increases can be relatively small in dollar terms but very significant in percentage terms. Apartment leases usually run twelve months and other types of real estate lease terms are usually counted in multiple years. Thus, this ultimate flexibility allows the self storage owner to take advantage of lowering rates when demand is low and raising rates when the demand is high. Many self storage management firms adjust their “street” rates every day, sometimes more than once a day, and set schedules for each tenant’s future rate increases, sometimes as often as twice a year. The ability to manage revenues is a very important and distinctive characteristic of self storage.

Lastly, we find that most self storage owners have a conservative streak that provides a lot of security in these troubled times. We see a summary of every self storage CMBS loan in the country on a monthly basis and we are amazed at the responsible amount of leverage that most owners encumber their property with. This trait not only protects the owner, but also collectively helps preserve an orderly market for those that want to sell or buy self storage facilities. I can assure you that many, if not most, other CRE owners are leveraged to the “hilt.” By way of example, there are a trillion and half dollars worth of CRE CMBS loans maturing in the next three years!

To a large measure, these positive fundamentals of our business have saved the day for self storage owners - so far! First, let us remember what the first six months of this debacle looked like in terms of the CRE market. The REITs’ stock values plunged because of the projected decline in property values and, more importantly, because of their excessive debt and the close maturities of that debt. Many of the REITs scrambled very hard to raise equity and refinance maturing loans, but it was at great expense to their shareholders in terms of dilution of the shares’ values. The combination of the high leverage on most of the CRE loans and the close maturities make their repayment problematic. The banks, and not just the big ones, simply do not have the capital to make new loans or renew the existing loans. Unfortunately, the banks simply still don’t have the capital or the risk appetite to make or renew many new loans. That is not to say that new loans are impossible to get, but it does say that new loans are going to be difficult to find and are going to be dramatically less generous in their terms. The current interest rates are going to be in the 6% to 8% range, with a loan term of 3-5 years, and on a very good day maybe 10 years. The underwriting of the loan will be more strenuous with the value determined by the trailing twelve months NOI divided by the cap rate. No proforma income or excessive “other income” is likely to be counted in the calculation of value. In most cases the loans will provide for recourse to the borrower, which is a significant change from the CMBS loans that they may replace. The cap rates have

also changed during the last year and the new loan proceeds may not be sufficient to retire the maturing loan amount, which might require the owner to put up more equity. Because of low leverage applied by many current owners, this will not impact as broad a spectrum of self storage owners as other CRE owners, however it will be a serious problem for those that it does impact.

Cap rates in the beginning of this period went up dramatically and quickly cut the theoretical value of all CRE, including self storage. Cap rates before the crash were significantly below the rates that were prevalent in the past 40 years (meaning higher values than were common in the past). However, because there were virtually no sales occurring, it was difficult to know exactly what the cap rates really were in the early months of the economic downturn. By looking at our comparable sales and listings at the time, it appeared the asking cap rates were roughly about 7.5% to 8.5% and the offering cap rates were at 10.5% to 11%. The sellers were saying “would I earn a better return just holding my property” and the buyers were just hopeful bottom fishers. Goldman Sachs was regularly projecting cap rates to go up by 500 basis points. The result was that there were not enough sales to accurately define a real cap rate for several months in the first part of 2009.

The cap rate spreads have now narrowed and are starting to stabilize in the self storage market and we are seeing transactions in the well-occupied, maintained, demographically superior properties at 8% to 10.5%. Most sellers are recognizing that 2006 and 2007 were years of exuberance in the market, both as to price and ease of sale, and the buyers are equally tamed by their experience over the last several months and thus becoming more realistic about pricing. The result is that once again there seems to be more rationality developing in the self storage buying and selling market and the pricing appears to be approaching a balanced equilibrium as to both price and velocity. With the reported, albeit modest, growth in the economy, the demand for self storage rentals seems to indicate that the underlying business is much less fragile than we had feared and the market for buying and selling self storage will be more accommodating in the months to come.

Having made these predictions, I would like to close with three cautionary comments. First, if you have a loan that is going to mature in the next year and half, start planning to replace that loan now if you can. Much of what I read in the financial press leads me to be very concerned that the smaller banks are going to be very restricted in CRE loans, including self storage, because of their past overaggressive lending and pressure from the FDIC. Secondly, now is the time to out-compete your competition by improving your property and marketing. A little money spent now when your competitors are holding back could improve your future competitive situation dramatically. Thirdly, be conservative with your cash and watch for signs that the economy doesn’t go in reverse. And lastly, of course, I could be all wrong. **MM**

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Property Showcase

Bentonville, AR • \$2,490,000

- 81,715 RSF
- 447 Units
- 94 climate controlled units
- Assumable non-recourse financing in place
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- Record of stable occupancy
- Excellent location near Walmart Corporate Headquarters



Larry Goldman, CCIM
913-339-0641
lgoldman@selfstorage.com

Corydon, IN • \$2,256,430

- 79,746 RSF
- 504 Units
- 30 climate controlled units
- 10% Cap Rate
- 6 onsite apartments being leased
- 81% Occupancy



Mike Helline
502-253-1811
mike@grisantigroup.com

Colorado Springs, CO • \$3,600,000

- 32,995 RSF
- 266 Units
- 8.66 Acres
- 15,000 SF office/warehouse
- Boat/RV parking and wash facility
- High occupancy
- Assumable Financing



Joan Lucas
720-855-6587
jluucas@selfstorage.com

Nixa, MO • \$995,000

- 22,548 RSF
- 198 Units
- 6.67 Acres
- Strong demographics
- Onsite office and apartment
- Dynamic location in Springfield suburb



Larry Goldman, CCIM
913-339-0641
lgoldman@selfstorage.com

Sandwich, IL • \$1,450,000

- 42,780 RSF
- 266 Units
- 10 Acres
- 5 Acres for expansion
- Property is gated with security cameras
- Additional income from cell tower
- Excellent upside potential



Bruce Bahrmassel
312-518-3550
bbbahr@aol.com

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- 97 Units
- 4.58 Acres
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- Potential for additional income



Larry Hayes
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larryhayes@selfstorage.com



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Garfield	\$750,000	Larry Goldman	913-339-0641
Gravette	\$800,000	Larry Goldman	913-339-0641

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Mead	\$925,000	Joan Lucas	720-855-6587
Rifle	\$810,000	Joan Lucas	720-855-6587
Superior	\$1,400,000	Joan Lucas	720-855-6587

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Pensacola	\$3,900,000	Bill Barnhill/Shannon Barnhill	251-432-1287

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Sugar City	\$2,600,000	Larry Hayes	406-728-0088
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Chicago	\$3,600,000	Bruce Bahrmassel	312-518-3550
Elgin	\$1,300,000	Bruce Bahrmassel	312-518-3550
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Sandwich	\$1,450,000	Bruce Bahrmassel	312-518-3550

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Corydon	\$2,256,430	Mike Helline	502-253-1811
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Mason City	\$1,350,000	Bob Randklev	319-533-6927
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Kansas

Kansas City	\$2,300,000	Larry Goldman	913-339-0641
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Crestwood	\$1,640,000	Mike Helline	502-253-1811
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Louisiana

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Houma	\$2,600,000	Jack Stumpf/ David Laney	504-366-6800 505-286-2060
Metairie	\$1,695,000	Jack Stumpf	504-366-6800

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Topsham	\$1,000,000	Joe Mendola	603-668-7000
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Baltimore	\$2,300,000	Grady Riggs	301-468-0606
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Swansea	\$3,000,000	Joe Mendola	603-668-7000
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Joplin	\$900,000	Larry Goldman	913-339-0641
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Sedalia	\$950,000	Larry Goldman	913-339-0641

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Kalispell	\$1,200,000	Larry Hayes	406-728-0088
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Hampton Falls	\$4,400,000	Joe Mendola	603-668-7000
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Stanhope	\$5,375,000	Linda Cinelli	908-722-5661

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Eunice	\$650,000	David R. Laney	505-286-2060
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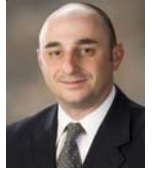
Joe Pelayo, CCIM, SIOR, CIPS of Total Real Estate Consultants in Coral Springs, FL joins Argus as our representative in South and West Florida. Joe has more than 20 years of experience in the real estate industry and has received several awards such as Top Producer and Costar Power Broker in 2006 and 2008 in South Florida. Joe can speak multiple languages and is one of the few brokers in the United States who has earned the top certifications and designations. He has held the position of Director of the Society of Commercial Realtors of Greater Ft. Lauderdale in 2007/2008 and is a member of the Certified International Property Specialists (CIPS) and the National Association of Industrial and Office Properties (NAIOP). Joe can be reached at 954-341-3294 or joeccimsior@yahoo.com.

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Congratulations to **Richard Minker, CCIM** and **Tyler Trahant** of MINKERTrahant & Associates for the sale of **Ideal Mini Storage in Terrell, TX!**



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