



SELF STORAGE SALES NETWORK

## Predator, Prey or Unaware?: Which One are You?

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by Michael L. McCune

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The economic environment of the last several months has been devastating not only to the stock market but also to the commercial real estate market. In fact, the problem is even more intensified in the real estate world because not only have prices dramatically fallen, but there are virtually no economically viable loans available to owners who want to refinance or to purchasers of properties. Few self storage owners realize the full extent of the devastation this credit crisis has had on self storage projects because unlike the stock market, there are no daily quotes in the newspaper or on the internet to tell you what is happening in the self storage world. While I can't tell you exactly how much your property value has declined, I can tell you that the average property value is down between 20%-25%, simply based on the change in cap rates. If your revenues are down as well, the value will also be down by roughly the same percentage as the revenues in addition to the above declines. Unfortunately, the decline in value isn't the worst of the problem. That distinction is saved for the resulting decline in the amount of your equity (after deducting debt) that results from the loan remaining the same and the value going down. This is, indeed, a very difficult situation.

When will this all end? As I write this, I have not seen any of my real estate prognosticators venture a good guess - and neither will I. However, I will quote a presentation given at the meeting of the Urban Land Institute last week, where Winston Churchill (1942) was quoted: "This is not the end. This is not even the beginning of the end. But it is, perhaps, the end of the beginning."

You are probably wondering about the title to this article by now; they are really strong words, so let me explain the situation. Starting at the beginning of this decade and lasting up until early 2007, the commercial real estate market was incredibly good to real estate owners. Interest rates were low and kept getting lower; loans were generous and easy to get; values kept rising; buyers were always ready and able to buy facilities and consumers had plenty of money (thanks to tapping their home equity loans) to rent self storage units to store their new toys. The fact was that if you owned a self storage facility you, along with all of your colleagues in the business, were becoming rich. All owners were in the same boat, going the same way and it looked like a luxury liner! Now fast forward to 2008 when the credit crunch first hit in midsummer. It really was "just the start of the beginning," although no one dared to know the dimensions of the ultimate problem. We still don't know and we may not know for some time yet!

As owners realized that the "cruise ship" was beginning to take on water, a not so funny thing happened: the ship divided into three groups when they started to evaluate the situation. *The Predators* got in the life boat and sailed to safety to sail again in the future; *the Prey* were thrown out of the life boat; and many of the others, *the Unaware*, went down with the ship.

The analogy gives us some idea of what is happening in the self storage real estate world today. Some owners and investors (The Predators) that have cash and good credit possibly sold early and are beginning to look for good deals. They can be very patient until the prices come down even more because they know that there are only a few buyers with access to financing. However, some owners (The Prey) have discovered their plight of declining values and are worried about the constant value of the mortgage eating away at their equity, not to mention declining cash flow because of the weak economy. Hopefully they had the good sense and fortune to have a long maturity loan to begin with. If not, they should immediately begin to think seriously about refinancing or possibly selling. The problem is that when the old loan has to be refinanced and the value is down, the new lender won't lend as much and the owner may have to make a serious cash infusion just to refinance with a lower loan. To continue the analogy; to keep your place in the boat you must carefully analyze the situation and act surely and quickly. Lastly, for those owners (The Unaware) who haven't reviewed their real estate situation to figure out exactly what they must do to resolve a potential problem, swimming lessons might be a good idea.

This analogy presents the gist of the situation, but some numbers might help you to understand the mechanics as well as the magnitude. The numbers are illustrative, but are scalable in either direction to suit your property. The first column shows the peak of the market and the second assumes the same revenues and a valuation at a 9 cap rate. Nobody knows for sure where cap rates are today, but many experts think that cap rates will return to historic norms, which is in the "9ish" range. The last column shows what will happen to value if the occupancy and rents are each down 5% and the resulting impact on the cash required to refinance the project. The loan to value ratios in the last two columns are very likely less than 75%, but rather than add another variable, I just used 75%.

	Summer 2007	Winter 2008-2009	10% Revenue Decline*
Revenue	\$300,000	\$300,000	\$270,000
Expenses	\$100,000	\$100,000	\$100,000
Net Operating Income	\$200,000	\$200,000	\$170,000
Value	\$2,857,000/ 7% Cap	\$2,222,000/ 9% Cap	\$1,888,000
Loan @ 75% LTV	\$2,142,000	\$1,666,000	\$1,417,000
Cash Required to Refinance		\$476,000	\$725,000

\*5% decrease in Rates plus 5% decrease in Occupancy

I believe that the math suggests a very serious problem on the horizon as this market moves forward; every day is one day closer to the maturity of the loan. Consulting a real estate expert specializing in self storage will either set your mind at ease or help you develop a plan to mitigate your situation. There are some very capable professionals listed herein and on our web page, [www.selfstorage.com](http://www.selfstorage.com), click on Argus. The best thing you can do is prepare yourself and not be caught unaware as the market continues to evolve around us.

*Michael L. McCune is President of the Argus Self Storage Sales Network, a self storage real estate brokerage and development company based in Denver. Argus also operates [www.selfstorage.com](http://www.selfstorage.com), a marketing medium for owners in the self storage industry. For more information call 800-55-STORE or visit [www.selfstorage.com](http://www.selfstorage.com).*