



SELF STORAGE SALES NETWORK

Broker Roundtable: The Southeast States

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by Michael L. McCune

*Our Roundtable of experts has gathered this month to discuss the Southeastern United States. We have asked our local Broker Affiliates to comment on the current self storage market in their areas and share their thoughts on how the self storage industry will perform in the future. Joining us in the discussion are **Dale C. Eisenman, CCIM** of Midcoast Properties, Inc. in Hilton Head Island, SC; **W. Frost Weaver** of Weaver Realty Group in Jacksonville, FL; **Bill Barnhill, CCIM, Stuart LaGroue, and Shannon Barnhill Barnes** of Omega Properties, Inc. in Mobile, AL; and **Grady Riggs** of Long and Foster Real Estate in North Bethesda, MD. Both current and potential self storage owners can benefit from the local knowledge provided by our experts.*

1. What has been your experience with the current lending practices of both local banks and the larger regional or national banks?

Weaver: My current experience is that most financing is through regional or local community banks that have a current banking relationship with the potential buyer. However, there appears to be some funding available through national contacts. An example of a current loan quote that I have recently reviewed was a 6.8% fixed for five years, based on 67% loan to value. For a three year fixed product, the rate was slightly below 6% with the LTV up to 70%.

Eisenman: Lenders fall into two basic categories, recourse and non-recourse. For non-recourse loans the properties have to be stabilized (not in rent up), income producing facilities. Typically portfolio lenders such as Life Insurance Companies who keep the loans and take the risk are making non-recourse loans with 60% to 70% Loan to Value ratios with very conservative underwriting standards. Recourse lenders such as Community and Regional Banks are making recourse loans to borrowers with good credit, substantial net worth and cash flowing properties at up to 80% Loan to Value. All lenders are discounting future projections and focusing on the most recent actual performance. Generally the tolerance for risk is small among all lenders, they all want “good safe” loans. Stated another way, if you don’t need the money you can probably qualify for the loan!

Barnhill: Local banks are the best source for financing in the current climate. Their feasibility and underwriting are more stringent with a lower loan to value and higher debt coverage rates. Banks want owners with a solid track record, and the larger banks are typically only interested in solid performing properties.

Riggs: National and regional banks are not lending aggressively and their terms are difficult to meet by most buyers. However, what I have found in many rural communities is that local banks are willing to work with buyers, particularly if they are familiar with the business. Though they may have tighter guidelines than before, they are

still more flexible and aggressive than most large banks. Additionally, there is a little known government program that is often overlooked. The USDA Business and Industry guaranteed loan program is targeted at rural communities with populations less than 50,000 and may offer alternative financing up to \$10 million for new buyers.

2. There is controversy about whether self storage is a recession-proof business or not. What is your experience as to changes in rental rate, rental concessions and the overall occupancies and turnovers?

Eisenman: Occupancies have softened in some areas by as much as 15% but most are seeing a reduction of around 5%. While self storage is performing better than other commercial real estate segments, it reflects the overall weakness in the housing market and general economy. While the days of being recession proof may be over (if they ever existed), it still appears self storage is weathering this “perfect economic storm” without the damage other real estate and businesses are experiencing.

Barnes: Recession-proof is not the best way to describe self storage; I would classify it more as recession-resistant. Self storage has not been as widely affected by past recessions as the retail sector has been. Overall, rental rates have decreased some while rental concessions have increased. This is due to the economy as well as overbuilding in some markets. Though some facilities might be able to sustain their occupancy by increasing concessions, the financial occupancy has declined somewhat.

Riggs: There is a consensus that we now know: self storage is not recession proof. While we can expect occupancy rates to track the economy to some degree, what was not anticipated is the impact of lending completely shutting down. So even if we have motivated sellers and qualified buyers, the hoops these buyers must jump through and the LTV requirements have proven to be prohibitive. Move-outs and late payments are on the rise making 2008 NOI's and values plunge. Rental rates are stable, but concessions are common, which is not what a new lender wants to see. Many small communities are one or two industry towns, so it doesn't take much to change the game. In Virginia and Maryland, new facilities and expansions that were planned are now on hold and/or some newly acquired vacant properties are back on the market. What's interesting is that vehicle storage is doing well and is increasing in many areas.

Weaver: Recent experience would indicate that self storage is not recession proof. The downturn in the housing market has had a definite negative impact on self storage facilities, especially in the smaller cities. For urban, well-located, established properties, there has been some drop in the occupancy of 5-10%. There is a definite indication that some renters are seeking to move out of their storage units to eliminate costs. I have not noticed a decrease in rental rates in North Florida, but owners are definitely being more creative in their concessions.

3. Please describe what you think buyers in today's market will look like.

Weaver: My experience is that most potential buyers would be considered investors that are seeking value-added purchase opportunities. There is a noticeable wider gap between current asking prices and initial offers. Buyers are testing the owners' true motivation, which can make the negotiations lengthier in attempting to find common ground. The good news is that there are viable buyers in the marketplace. They are definitely being more selective and analyzing the property operations more thoroughly.

Riggs: I still continue to receive many inquiries on my self storage listings, so I can only assume that there is still strong interest in this asset class. But the offers we're now seeing are from bargain hunters and "bottom feeders" offering wacky terms. I feel that there is a level of angst with average buyers not knowing what's going to happen next in this economy and fearing that they may be buying too soon. It appears that these buyers are waiting to hear the "bell" ring and the town crier saying that we've hit bottom. Once this happens, I think they will make their move. I have heard of several direct buys in the Washington D.C. and other major MSA's not hitting the radar. This is not surprising because this region has a history of low turnovers.

Eisenman: Buyers of self storage fall into many categories now just as they have in the past. Those who are in the industry probably see the future in self storage as brighter than those outside and may be more inclined to try to acquire more properties during this economic slowdown.

LaGroue: The landscape for purchasing self storage properties has drastically changed over the last year and a half. There are three potential buyers in today's market, institutional buyers focusing on limited areas of the Florida panhandle; individual investors looking for a "deal"; and newcomers that are still looking to enter the self storage business.

While these three different types of buyers have varying goals, they are all faced with the reality that cap rates are trending upwards around 9% and the fact that it's becoming more difficult to obtain favorable financing. Regardless of the type of buyer, I think we'll see the gap between sellers' expectations and what buyers are willing to pay shrink. In our markets, we've also encountered some investors that are looking for "deals" contact local banks to inquire about distressed properties or properties that are on the verge of being distressed in hopes of entering a market at a discount.

4. Are owners in your market starting to deal with expiring loans on their facilities? How are they handling this situation in light of the current lending market?

Barnhill: Some self storage owners in our areas are beginning to have to deal with loan maturations on their properties. Owners with properties which are well occupied and performing usually are capable of obtaining local bank financing with debt coverage ratios of 1.35 to 1.50 with rates in the 6.75% range. Owners whose properties have low occupancy rates such as in the 40% to 50% range and negative cash flow would have difficulty obtaining a good loan. In those cases banks would be depending more on the financial statement of the owner.

Eisenman: A more pressing issue may be servicing existing debt by those whose cash flows are stagnant, declining or not yet stabilized. It will be interesting to see if lenders work with self storage operators through loan restructuring to get through this difficult period. Lenders have plenty to occupy their attention with the housing crisis, bankruptcies, credit issues, Wall Street challenges and auto industry difficulties. Self storage will be just a small segment of that matrix and may have the best prospects of weathering the storm.

Weaver: I do not have any recent experience with any owners that are attempting to refinance expiring loans. However, if these properties are well positioned in the marketplace, my assumption is that financing is available based on the criteria discussed earlier in this article. Lenders are still looking for solid performing properties with stabilized occupancies.