



SELF STORAGE SALES NETWORK

Broker Roundtable: The North Central States

Inside Self Storage – July 2009
by Michael L. McCune

*Our Roundtable of experts has gathered this month to discuss the North Central 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 **Bruce Bahrmassel** of Landstar Realty Group in Chicago, IL; **Robert Brehmer** of NAI Daus in Cleveland, OH; **Sheldon Johnson** of Johnson Group in St. Louis, MO; **Larry Goldman, CCIM** of RE/Max Best Associates in Kansas City, KS; and **Chris Hitler** of Investment Real Estate Specialists in Mequon, WI. Both current and potential self storage owners can benefit from the local knowledge provided by our experts.*

1. The market has provided a unique dilemma for owners because cap rates are going up dramatically which causes values to decrease and loan to value ratios to increase. Are you seeing concern in your market about this problem, and how are owners finding ways to solve it?

Goldman: I have been involved in transactions where banks are replacing thinner, less experienced borrowers with more seasoned players, which leads to a consolidation of the industry. In some cases, while the banks do not control the properties, the banks are taking an active role in the negotiation of the sale. They tend to be win-win-win transactions as the sellers walk away whole, the lenders are keeping quality loans with stronger borrowers, and the buyers are picking up great assets with terrific loans in an industry that is normally very difficult to buy into. In other cases, sellers are more open to carrying paper than they have been in the past and many buyers and lenders understand that the storage industry is more desirable than retail and office properties in this economy.

Hitler: In Wisconsin, the vast majority of storage facilities are owner/operator-based, and the majority of these have been owned for ten years or more by the current owner. Consequently, most facilities in Wisconsin are not saddled with the debt levels that many recent storage deals have used. Having said this, we are seeing a couple of properties surface that were either refinanced or built within the last 5 years that are unable to make their debt payments and are soon to be in receivership. The workout will likely come from a third party with storage management experience that can stabilize the property's operations and enable it to be sold at a valuation that is close to the mortgage amount.

Brehmer: Owners in Ohio are aware that cap rates are increasing, in addition to loan to value ratios increasing. Some lament that they did not sell when the opportunity was there. I've been suggesting partial or total owner financing given the limited returns in alternative sources of investment. In the current economy, a seller could invest their proceeds with a bank or in a CD and earn a paltry but safe return, or they can provide the

financing for the deal and earn a higher rate of return, which is secured by the borrower and the property.

Bahrmassel: Self storage owners in Illinois and Indiana are starting to understand the realities of the current market where values can, and do, go down. One of my clients has significantly lowered his asking price, and as a result, a contract was generated from a buyer who had looked at the property several months earlier when it was priced about 12% higher. Another has agreed to carry a second mortgage to facilitate a transaction that they never would have considered a year ago. Having a ready, willing and able buyer in this market is very tough to pass up.

Johnson: Due to the short term nature of self storage tenants, lenders are being required to take a harder look at credits, usually requiring 25 to 35% of equity in transactions. Also, the regulation “mark to market” approach is causing appraised values to diminish by utilizing higher cap rates. Owners are adjusting by being more realistic about the activity from potential buyers. Also, some owners may choose to escrow funds to guarantee a higher occupancy level to help a transaction close.

2. Many owners across the county have told us that their rates, occupancies and concessions are currently stable, but that they are seeing delinquencies increase. What is the experience of owners in your area and how are they addressing increasing delinquencies?

Hitler: I have spoken to several hundred self storage owners this past quarter and have been pleasantly surprised by their responses. Business is either good or very good and the vast majority of owners are seeing occupancies at or exceeding historic norms without corresponding increases in concessions. Only a small minority have seen their occupancy fall in the past six months. Delinquencies have ticked up for most owners, but only by a few percentage points.

Johnson: In the St. Louis area, we are seeing a small increase in delinquencies due to the general economic conditions. Time will tell if this trend is more of a temporary effect or if the overall economic climate is changing.

Goldman: Delinquencies are often a function of management. In Kansas and Missouri, we are not seeing an increase in delinquencies across the board, only in certain situations where management does not stay on top of their collections.

Brehmer: The owners I have spoken to in northeast Ohio are telling me that delinquencies have only marginally increased. Moreover, they are leasing units to foreclosed homeowners who are seeking storage for their excess belongings as they move into smaller homes. This will tell whether these tenants will pay until the total rent eclipses the value of the stored items. Rents in these areas are also holding steady.

Bahrmassel: Owners in my market have reported increased concern over delinquencies. Some say they are being more aggressive in their collections and voicing concern that

renters who are more than 60 days past due don't beyond that point where an asset may turn into a liability.

3. In this very difficult market with many properties for sale, how do you help the project get visibility and attract more buyers?

Hitler: Currently there is a wide chasm between Seller and Buyer valuation expectations. Sellers still have 2007 valuations in their heads and have difficulty accepting the reality that even though their business is generating the same revenue as 18 months ago, their property's value has fallen 10% or more because of macroeconomic conditions beyond their control. Buyers, on the other hand, see what is happening in the residential market and believe that these conditions must carry over to self storage. In order to close this divide between Sellers and Buyers, Sellers need to be more flexible especially if securing bank financing continues to get more difficult for Buyers. I foresee more deals utilizing seller financing and sellers also need to be prepared to throw in other terms that improve the value for buyers.

Bahrmassel: In addition to the traditional marketing methods that Argus brokers employ like our newsletter, tradeshow participation and regular contact with buyers, the most important thing we can do in this market is to make sure that properties are priced correctly. Some clients who set their prices based on old assumptions have seen their properties languish on the market. Others who are more in tune with current values and/or have reset their pricing to reflect what is going on in the current market are receiving considerable attention, which may ultimately result in a transaction.

Goldman: Now is the time to explore new venues to get the word about self storage out to a newer profile of investors who are sick of the uncertainty of the stock market, retail centers, office buildings, etc. In addition to our traditional marketing venues, we are expanding our programs to include more innovative alternatives such as Craig's List, and simply increasing our presence at state trade shows. Also, reaching out within the commercial real estate brokerage community is an effective way to increase interest in the self storage asset class. In today's market, non-storage brokers are more open to bringing their buyers to us, as the general velocity of investment real estate has slowed down.

Johnson: Sales activity can be increased by targeting specific buyers, especially in small town markets. In many cases, the right buyer for a property can be found in the same local area as they are the most familiar with that particular market. Local advertising in newspapers is a way to reach out to individuals who are not as familiar with the larger self storage industry publications. Attendance at local and national tradeshows is another great way to increase the exposure of self storage properties for sale to very targeted groups of potential investors.