



SELF STORAGE SALES NETWORK

# Market Monitor

"America's Premier Self Storage Brokers"

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## Summer is Almost Over... But What About the Recession?

by Michael L. McCune

These days, it is easy to spot the signs that summer is coming to an end. School supplies are on sale and kids everywhere are trading beach towels for backpacks. I am not nearly as confident, however, that the recession is over, despite Chairman Bernanke's statement this last week. Please forgive my skepticism, but I seem to remember the last Chairman of the Fed telling us that securitized bonds, collateralized by real estate loans, were actually a way to spread the risk and were good for the market. While I would agree that many elements of the economy appear to be better now, I'm not so confident that Commercial Real Estate (CRE) is one of them.

I really don't know how it is going to turn out, but I do know that every one of my colleagues in CRE has the same questions. I will try to briefly summarize the issues in CRE so that you see the challenges that we all face. Before I begin, however, let me say that I do believe that the impacts of the situation are going to have generally much less of an impact on self-storage owners than on other types of real estate, like office, retail, apartment, or hotel properties.

Here is what really happened: some years ago the investment banks and the mortgage brokers got together and decided that they would use commercial real estate loans as collateral for securities. Then, they sold these securities to investors such as pension funds, insurance companies, foundations, and even the banks themselves. One of the new securities was a Commercial Mortgage Backed Security (CMBS). The banks and brokerage firms convinced almost everybody, including the Fed, that CMBS securities were even more secure than the underlying loans collateralizing them. Most importantly these securities were very profitable for the mortgage brokers and the investment bankers. And because there was no personal liability, the borrowers thought that CMBS loans were terrific too.

Thanks to the Fed's low interest rates and the borrowers' penchant for these deals, the business got competitive, and it became difficult for the investment banks to find enough good real estate for collateral to keep the fees flowing. The banks consequently decided that "lousy" collateral was almost as good as "good" collateral, and that the "good" collateral could secure larger loans. In other words, they were willing to lend more on less collateral, and willing to look the other way on real property values. They were greedier still, however, and they started speculating in Credit Default Swaps. Without getting into detail, these swaps just served to make the Mortgage Backed Securities (MBS) market merely a craps game.

In the late summer of 2007, the market discovered that some of the risky Residential Mortgage Backed Securities (RMBS) were not working out, and the whole business of Mortgage Backed Securities, including CMBS, began to crumble. The net result was that prices for real estate of all kinds fell dramatically. Houses lost about 40% of their value and prices for office buildings were cut in half. Retail and apartment properties values fell too, but exactly just how much is hard to calculate!

The CMBS loans are still looming, however, and the total amount of the loans were based on the previous real estate values. In the next four or five years, there are approximately \$1.5 trillion of CMBS loans due, and about \$800 million due in the next two years! With little doubt, the vast majority of these loans are larger than the actual property value by a considerable margin.

Let's look at the possible ways out of this mess. Only one of them is very likely.

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**Values of commercial real estate go up very dramatically.**

Unfortunately, this scenario is improbable because there will be a lot of commercial properties for sale when the loans default. When there are a lot of properties available for sale, prices do not usually increase. Additionally, it is unlikely that there is going to be much financing available to purchase this real estate.

**The trustees responsible for the securities mess reduce the amount of the loans and keep the current owners of the properties in place.**

Once again, this would be a very unlikely situation because the securities owners would be absorbing all the losses. These owners are often commercial banks that would have to take a loss, and their capital levels would subsequently plummet, and lending would decline. By all accounts, the litigation would be overwhelming before this would be resolved. Quite a “Catch-22!”

**Lenders lower the borrowers’ debt-service payments without changing the loan balances and instead extend the loan.**

This seems to be the developing course of action for most lenders, including most commercial banks. One of the deals we have worked on provides an example. The trustees reduced the debt service by one-half, extended the loan for three years, and tacked on the deferred debt service to the end of the loan. In this situation and similar ones, the lenders simply pretend that the size of the loan reflects the value of the property. They then hire an appraiser to justify the assumptions—just what the banks did when they made the loan in the first place! With this method, the lenders don’t write off any loans or take any *book* losses. While it sounds like a good deal for the borrower (and it may well be), it is more likely just a postponement of the default unless values rise

dramatically.

We have seen many variations on this proposed type of solution in recent weeks. Most of them, however, are still in the initial, “talking” stages, and have yet to be implemented. Put simply, the banks are just kicking the proverbial ball down the field, in hopes that some miracle will occur. Indeed, as one wag pointed out, “A rolling loan gathers no earnings losses!”

Whether or not the real estate business, including self-storage, will prosper in the near future is still unknown. However, it is likely that there will continue to be serious consequences for all real estate owners well into the next couple of years. Some owners will lose their property and everyone will suffer with depressed property prices for a long time.

For those of you that have stayed with me, there is some good news for self-storage owners amid the gloom. First, self-storage is *hands down* the very best type of real estate to own in a recession and probably at any time at all. The rents are more stable, the expenses are much lower, and there are very few self-storage owners in or near default on a loan. We know this because we have access to information on every CMBS loan for all types of real estate. This information shows that two things are true of self-storage: 1.) the cash flow is generally more consistent and stronger by a fair margin; and 2.) the average self-storage owner has substantially lower leverage on his property than most types of other real estate. Apparently self-storage owners are inherently more risk averse than most real estate owners and they should be commended for their foresight. Not many real estate investors, lenders, or investment bankers had the wisdom to understand that financial leverage is a double-edged sword. **MM**

*Michael L. McCune, President of the Argus Self Storage Sales Network, can be reached at 800-55-STORE or [mccune@argus-realestate.com](mailto:mccune@argus-realestate.com).*

For those of you who would like to learn more about Mortgage Backed Securities, visit this link <http://www.youtube.com/watch?v=UC31Oudc5Bg> to watch a video that will help you gain a clear and credible perspective of what has happened in the last 18 months. It is one of those things that will make you want to both laugh and cry!

*(continued)*



# Property Showcase

## Garfield, AR • \$750,000

- 18,460 RSF
- 55 Units
- 6.92 Acres
- Built in 2001
- Located minutes from Beaver Lake and Rogers, AR
- 2,166 SF residence/office/apartments
- Land available for expansion
- History of high occupancy



**Larry Goldman**  
 913-339-0641  
 lgoldman@selfstorage.com

## Terrell, TX • \$640,000

- 40,503 RSF
- 255 Units
- 8.53 Acres
- Well located
- Great Access
- Land for expansion
- Tremendous occupancy upside



**Richard Minker & Tyler Trahant**  
 888-7-MINKER  
 rminker@minkertrahant.com  
 ttrahant@minkertrahant.com

## Sandwich, IL • \$1,499,000

- 42,780 RSF
- 266 Units
- 10 Acres
- Five acres available for expansion
- Facility is blacktopped and gated with security cameras
- Additional income from cell tower



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

## Kittitas, WA • \$150,000

- 11,320 RSF
- 48 Units
- 2.21 Acres
- **Distressed self storage - Bring Offers!!**
- Room for expansion
- Low maintenance site
- Solid rental history
- Rental rate upside



**Ryan Layton**  
 509-435-2424  
 ryan@areanw.com

## Crestwood, KY • \$1,640,000

- 27,165 RSF
- 187 Units
- 2.07 Acres
- Excellent upside potential
- Consistently high occupancy
- Low competition in the area
- Property is in excellent condition



**Paul Grisanti & Mike Helline**  
 502-253-1811  
 mike@grisantigroup.com

## Omak, WA • \$1,050,000

- 15,552 RSF
- 175 Units
- 37,461 SF Land Area
- 5,000 +/- SF adjoining property available for expansion
- Owner financing available!
- 97% Occupancy
- High visibility location



**Ryan Layton**  
 509-435-2424  
 ryan@areanw.com

## Stanhope, NJ • \$5,800,000

- 49,302 RSF
- 526 Units
- 5.691 Acres
- State-of-the-art facility
- Located on main road approx. one mile from Route 80
- Climate/humidity controlled units
- U-Haul dealer



**Linda Cinelli**  
 908-722-5661  
 lcinelli.lcrealty@earthlink.net

## Tonasket, WA • \$550,000

- 8,447 RSF
- 74 Units
- 2.6 +/- Acres
- 1 acre of land available for expansion
- Onsite manager's residence
- Limited competition in the area
- Owner financing available!



**Ryan Layton**  
 509-435-2424  
 ryan@areanw.com



# Sells Self Storage Nationwide!

- Over \$129 million in self storage properties currently for sale
- Prices range from \$150,000 to over \$6.1 million to meet the needs of every buyer
- Check out our current inventory of 73 properties listed in 26 states and contact the listing broker for more information or visit [www.selfstorage.com](http://www.selfstorage.com)!

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Mead \$925,000 Joan Lucas 720-855-6587

Superior \$1,400,000 Joan Lucas 720-855-6587

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