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Financing and capital market update: The changes and effects it is having on self storage

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The nationwide commercial real estate credit crunch has created a market that is much more volatile and conservative than the past several years, and has also redefined lending expectations and options for self-storage owners and investors.

For starters, expect the bond market for all types of investment vehicles - whether commercial paper, commercial mortgage backed securities (CMBS) or collateralized debt obligations (CDOs) - to remain in their imbalanced state for the short term. Virtually every CMBS lender is currently sidelined by financing rates and terms that are unattractive to borrowers.

Before the crunch hit in mid 2007, we were in a market where shorter-term money was priced as much as three percent higher than long-term loans. While short-term money rates have decreased, long-term rates have increased in the past year. Today's short-term rates are more attractive than longer-term options.

Next, we anticipate spreads to decrease slightly when the market settles, while Treasuries simultaneously increase as investors move to other investments from this traditional safety position. Do not be surprised if spreads decrease while the overall rate goes up, as the index may move more inversely than the spread.

Today's Self-Storage Financing Options

Storage owners seeking to refinance or acquire properties are asking if it now makes better sense to lock into a fixed rate deal for five years or longer, or float on a shorter-term basis. These decisions are certainly harder when relative interest rates are as closely aligned as they are today.

Variable rate deals offer you flexibility to prepay, the ability to ride the market if rates decline further, and the opportunity to grow your income through expansion or continued operations and then refinance or sell later. However the major exposure for variable rate loans is if the rate increases more than fixed rate pricing. We're seeing more owners select shorter-term loans in today's interest rate environment.

We're often asked how activity on Wall Street affects a storage facility on Main Street. Wall Street financial instruments like CMBS and CDOs brought unprecedented liquidity to the self-storage financing arena and offered aggressive debt to commercial property owners not previously available from the banking community.

But now we have an entirely different - and much more conservative - playing field. CMBS deal volume will continue to be virtually dormant this year. Most conduit lenders have reduced staff and, in some instances, stopped quoting deals temporarily or permanently or have exited the market completely. With conduit loans sidelined, there are limited non-recourse loans available today.

Back on Main St., banks continue to lend to the self-storage community. Their position hasn't changed as dramatically because banks traditionally deploy more conservative lending approaches

than CMBS lenders. While some banks have recently moved to more conservative positions, you should be able to obtain terms similar to those available in 2007.

Life insurance companies will continue to lend to self-storage owners on a limited and select basis. They are seeing less of their current loans being paid off and thus have lower demand for new product. From a priority standpoint, they will also serve their existing client base more than new borrowers.

Life companies are conservative lenders who only finance higher quality assets - typically in the 65 percent to 70% loan-to-value range, sometimes as high as 75 percent. However, there are now more life companies willing to lend on smaller deals in the \$2 million to \$5 million range.

Structured deals on non-stabilized assets are also becoming more conservative and pricier, with lenders cherry picking deals for their structured finance terms. Transactions oftentimes have to be greater than \$10 million to get the attention of these lenders. These deals are often priced 400-plus basis points over Libor with fees at the transaction's beginning and exit, and with durations typically lasting two to four years.

So Now What?

Many property owners simply do not have the option of riding out the current market, and regardless of the lending option, will encounter a more conservative financing environment. For these owners, the "now what?" question can best be answered by remembering that everything is relative and that capital is still available today to support your storage investments, albeit in many instances with less leverage.

If you're looking to finance, be sure to do your homework on changing markets and lending options, and utilize advice and guidance from mortgage experts to ensure you make the best move to support your financing needs.

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