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The self-storage industry is adapting to meet the demands of the changing economic environment

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The past twelve months have been challenging in the self-storage industry. This is not terribly different in many other commercial real estate sub-sectors, I suspect. This is due in large part to the problems in the credit end of the business. The so called "sub-prime mess" has had a ripple effect throughout the credit markets and caused many transactions to be re-negotiated.

There has been a pervasive fear in the market as both lenders and investors are hesitant to make commitments to transactions, be they re-finances or financing of sale transactions. The pendulum has swung severely in the opposite direction of where it had been in the spring of 2007. This is, in my mind, a fairly typical overreaction from an historical perspective. The pendulum is bound to return to the mean in a matter of time, but until it does the commercial real estate industry will have to adapt to the changed environment.

The self-storage industry has not been immune to these global problems with credit. The easy credit which the industry benefited from in the mid 2000s led to a wealth of sale transactions and very attractive re-financings. The low credit rates pushed capitalization rates down to historically unprecedented low levels and values to stratospheric levels.

Over the past year as the credit crisis has played out, sale transactions came to a relatively screeching halt. Buyers, who could no longer obtain low financing rates, quickly adjusted their offering prices to reflect these new realities. Meanwhile sellers balked at the new economic realities, preferring to wait out the crisis and see if the markets returned to the recent past levels.

It is my opinion that these new economic realities are here to stay at least for the near to mid-term. Non-recourse and construction financing is very difficult to obtain as lenders scrutinize transactions much more closely. This is not necessarily a bad thing since there was a lot of self-storage product which was constructed throughout New England which still remains to be absorbed.

I am however sensing a change in the attitude of some sellers. They are beginning to understand that the self-storage REITs are no longer aggressively pursuing B/C properties and paying capitalization rates in the 7%-8% range. Other buying entities generally have equity partners with more demanding return requirements due to the perceived high risk levels. This has caused capitalization rates to rise.

There is an increasing willingness of sellers to accept offers more reflective of the current market. The problem still remains that once the offers are accepted, there remain many hurdles to overcome to close the transaction. These include continued difficult financing markets, more demanding buyer requests and buyers being more thorough during due diligence.

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The shift in seller's attitudes towards understanding that the higher capitalization rates are here to stay, is only just beginning. Over the next twelve to eighteen months, we will continue this trend. This will lead to more transactions getting done. In many cases self-storage facilities will be infused with much needed new capital, thereby increasing the prospects for success.

This process that the self-storage industry is undergoing will take time. It is not however unique to our segment of the commercial real estate market. I am not generally seeing disaster scenarios out in the market nor do I expect that to occur on a widespread basis. We will have isolated foreclosures but that will most likely happen to projects which were poorly planned and or located. Overall, I expect the sale markets to accelerate through year end and hopefully credit to become more available as the crisis winds down.

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