



nerej

Lenders are willing to lend on self-storage facilities

January 15, 2009 - Connecticut

The great myth that has been propagated by the self-storage industry is that our industry is "recession proof". While that proved to be helpful in selling pre-engineered buildings, the simple fact of the matter is that the industry is not recession proof.

A little common sense would tell you that if your household budget becomes constrained due to job loss or job uncertainty, the first thing that will happen is you cutback on non-essential expenses. Storing seldom used items is in many cases not essential. You will most likely; throw them out, sell the items or move them to your basement rather than pay \$100 to \$200 per month to continue to store them. While the industry can benefit to some extent from people in transition (i.e. foreclosure) since they have to store their items somewhere during transition periods, the reality is delinquencies tend to rise during this period as well.

This industry has seen tremendous growth over the past 25 years. We now have four self-storage REITs that did not exist 20 years ago. During the past five to ten years we have undergone a period of consolidation and expansion in the industry that will in fact continue once the economy rebounds. Don't be surprised however to see at least one of the REITs swallowed or carved up as the current recession progresses.

Is it all doom and gloom in 2009? The short answer is probably yes to a large degree. Our surveys show increases in vacancy rates in many areas of New England, increases in delinquency rates and weakening overall demand. Not many owners really want to recognize this, but unfortunately, it's true.

The good news is there appears to be plenty of equity money sitting on the sidelines waiting to acquire self-storage facilities. The reason is that this is and will remain a viable industry that serves the needs of a population that tends to hold on to their possessions. Are there lenders still willing to lend on self-storage facilities? Yes, in fact there are. The reality is that loan to value ratios have widened, meaning you better be prepared to invest significantly higher amounts of equity than in the past.

The problem is there may continue to be a dearth of transactions in the market for a good portion of 2009. There is still a disconnect between what sellers want and what buyers are willing to pay for properties. I saw this beginning to occur in mid 2007 and have continued to see a similar trend throughout 2008. Owners of self-storage properties in general are not yet willing to recognize that the ballgame's changed and that their properties have diminished in value. They know that their 401Ks have diminished because they can see the real time values reflected in the stock market. In real estate we don't have instant market feedback with real time property valuation.

It has been said to me by several real estate investors, "I haven't suffered any diminution in value if I don't have to sell". I think on many levels this is delusional. If you were smart enough not to over leverage your property and have a stable tenant base, a case can be made that you can ride the

storm out and wait for the market to turn in your favor, which it inevitably will. I don't think this is the case for the majority of self-storage investors. Values do in fact fluctuate. Most were willing to recognize this when they were looking to refinance and pull monies out during the good times. The self-storage industry was caught in the low interest rate, low capitalization rate bubble that all other commercial property types experienced. While interest rates remain at historically low levels, lending standards have significantly tightened and equity return requirements have significantly increased to reflect the increased market risks. The pendulum is swinging in the other direction and it doesn't appear to having come close to stopping. It is likely that the pendulum will swing too far in the other direction as it is prone to do. At this point you'll see the investors step in, transactions will occur and the beginning of the recovery will have commenced.

Patrick Lemp, MAI is a principal with Self-Storage Consultants, based in Hartford, Conn.

New England Real Estate Journal - 17 Accord Park Drive #207, Norwell MA 02061 - (781) 878-4540