More Deals and Attractive Loan Programs Brighten the Future for Self Storage

By Laura Williams-Tracy

Self storage is putting distance between itself and bad memories of the recession as brokers close more deals and financiers have more attractive loan programs to offer.

One of the brightest signs of an improving marketplace is the return of non-recourse commercial mortgage-backed securities (CMBS) loans as a financing option. "People are calling it CMBS 2.0, and the good news is it's back," says Jim Davies, a partner with Talonvest Capital Inc. in Costa Mesa, California.

CMBS loans were a major factor in the easy lending environment that permeated the mid-2000s. In 2007, at the peak of the commercial real estate market, banks issued $230 billion in CMBS loans nationally. To get a sense for just how far the market fell, consider that in 2010 just $11.6 billion in CMBS securities were issued. Experts predict $50 billion this year.

Since the summer of 2010, large banks such as JP Morgan Chase & Co., Bank of America and Wells Fargo have issued new CMBSs, which have revived commercial real estate lending. To create CMBS, banks make commercial property loans and then bundle those mortgages which, through the securitization process, become bonds. The growing availability of this credit helps lift property values.

One reason CMBS lending has made a return to the self storage market is because lenders recognize that the industry out-performed other types of commercial real estate during the recession, Davies says.

Talonvest recently launched a non-recourse fixed rate loan program for self storage owners with terms that include a 30 year amortization schedule and a maximum loan to value ratio of 70% or a bit higher for loans of $3 million or greater. Davies says other CMBS lenders have minimum loan amounts of $7 million or $10 million or more, but his firm is the only one actively working with storage owners on smaller deals.

"We're actually going below $3 million per property if there are multiple properties from one borrower" Davies says.

"There are more lenders than quality properties to finance right now."

~ Jim Davies
Talonvest Capital Inc.

On the Upswing

More available credit and two positive quarters for the large real estate investment trusts (REITS) have brokers saying business is on a definite upswing.

"We had a great year in 2010 volume-wise. It was as good as any of the big years that we had through the run up," says Mike Mele, senior director of the national storage group for Marcus & Millichap in Tampa, Florida.

Of the 21 deals Mele closed, only one was financed. The rest were cash deals. "Velocity is definitely picking up both on the distressed and non-distressed side," Mele says. "If people want to get deals right now in this type of economy, cash is king."

"I think distressed properties are the bulk of what's being sold."

~ Mike Mele
Marcus & Millichap

Mele says he sees primarily two types of buyers thriving in the market: investors who did not expand heavily during run up so they have money to buy now, and seasoned self storage investors who sold at the height of the market and are buying properties now valued at half the prior valuations. A third group is hedge funds and institutional investors who see self storage on the uptick and want to jump in.

Through 2009, as operators saw their revenues and property values plunge, banks and owners often stuck to their current lending terms even if the debt had matured, just to keep from forcing more distressed properties onto an already deeply troubled market. By last year, banks were forcing many of those properties onto the market.

"2010 was a very acceptable year, and certainly an improvement over 2009," says Nick Malagisi, national director of self storage for Sperry Van Ness Commercial Real Estate Advisors. "We already have under contact so far this year the volume of properties we closed on last year."

Expecting Better Performances

Malagisi says he expects that properties coming on the market in 2011 will be better performing than the first to hit the market.

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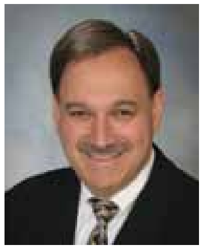
Of the 21 deals Mele oversaw last year, 12 were distressed and nine of those were sold by a bank. "I think distressed properties are the bulk of what's being sold," Mele says. "There's still a lot of properties working their way through the system; the banks are sending them out one at a time."

That volume will likely increase this year. But financiers wonder if distressed properties will be able to qualify for credit. "There are more lenders than quality properties to finance right now," Davies says. "A number of lenders probably won't achieve their volume goals because too many lenders are back in the CMBS market at once, and everyone is competing for what's currently not a large pool of properties that are highly financeable."

Buyers still face stiff underwriting standards to secure financing. Lenders now require 30% to 35% equity, instead of 20% or less necessary in better times, Malagisi says. SBA lending, which recently became an option for self storage owners, can be helpful to some smaller owners, who can finance up to 80% of value.

Small Owners Still Face Challenges

Among those facing the biggest challenge are small owners who need $1 million or $2 million to finance. Such small loan programs just haven't returned in force yet, and lenders who are willing to make such loans are only lending at 65% of value.



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Nick Malagisi
Sperry Van Ness

That's difficult for many owners, since the average self storage sale is $3 million, Malagisi says.

For those buyers or owners who can qualify, now is a great time to refinance. Interest rates are in the mid-5% range and the availability of non-recourse, fixed-rate financing is adding to downward pressure on cap rates.

Many owners who see their debt maturing in 2012, 2013 and 2014 are beginning to explore financing options, believing that interest rates will go up and provided that prepayment penalties aren't too exhorbitant, Davies says.

Because of the recession many owners' incomes have fallen. Once higher cap rates utilized by appraisers are factored in, along with the reduced loan-to-value requirement, borrowers often must put additional equity into the deal to pay off loan balances that are sometimes higher than the new loan amount they qualify for today.

"We're refinancing properties now where the owners are putting in $200,000 to $1,000,000 of additional equity to pay off their existing loans." Davies says. "But at least they are locking in very low long term fixed interest rates." ❖