



Financing For Self-Storage

UNDERSTANDING THE CHALLENGES

By Erin Henley

With the thawing out of frozen capital markets, self-storage investors are finding it easier — though by no means without challenges — to obtain financing with which to acquire facilities. However, finding and qualifying for money to support new development continues to be a rare feat.

“Relative to the last couple of years the capital markets have improved dramatically, which has definitely made financing more readily obtainable for existing facilities. Most notably the CMBS market has come back within the last six months, which has opened up a major source of liquidity and made it much easier to obtain debt on core stabilized deals, thereby alleviating some of the pressure on other sources of capital,” states Shawn R. Hill, principal of Chicago-based The BSC Group, LLC. He adds, “The change in SBA lending guidelines has also provided an alternative funding source that was not available heretofore. With respect

to development capital, there are still many challenges as lenders are too busy cleaning up the mess from the last go-around to have much interest in taking construction risk.”

Aaron Swerdlin, senior managing director for Houston-based Holliday Fernoglio Fowler’s (HFF) self-storage group, agrees that finding cash for building new sites is difficult. “Only the best in class can get done,” he says, adding that for acquisitions or refinancing, money is available on a relative basis, with the best terms available for deals valued at \$15 million or more within the country’s top 15 metropolitan statistical areas (MSAs), including New York City, San Francisco, Los Angeles, Houston, Dallas, and Chicago.

“Life insurance companies remain very interested but are more conservative, though the most flexible. With banks, it depends on the market. Banks are still having a tough time with commercial real estate,” Swerdlin states.

One problem in the self-storage invest-

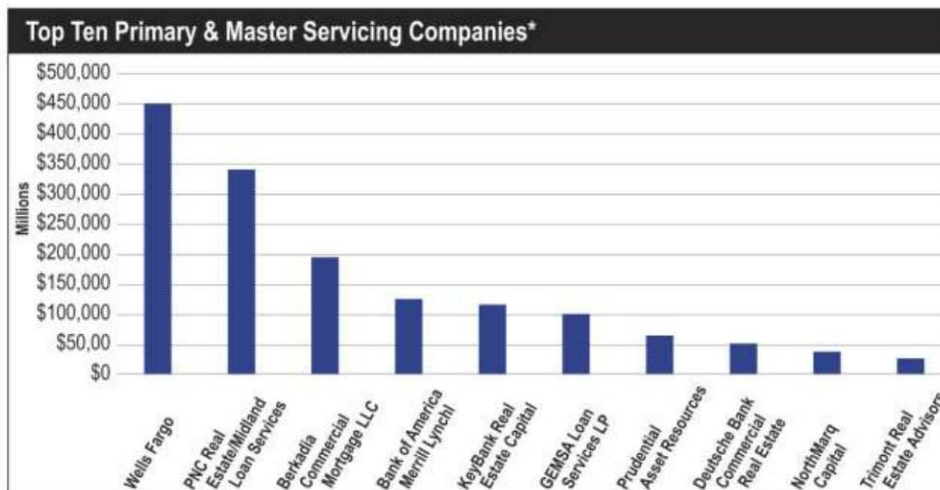
ment market, according to Swerdlin, is that “there seems to be a lot of chatter taken out of context or applied relatively” by investors, who hear about exceptional deals or transactions in major markets and think that those deals are applicable everywhere. “Everything is calibrated to the market,” he says, noting, for example, the financing terms for a deal on a property in New York City are not going to apply in a secondary market like St. Louis.

Cap rates are indicative of these differences. While the overall cap rate for self-storage sales thus far in 2011 is 7.4 percent, according to HFF, rates range from 6 percent in places like New York City, San Francisco, Los Angeles, and the urban areas of Chicago and Miami, to 7.0 to 7.25 percent in the rest of the top 15 MSAs, with secondary markets 150 to 200 basis points higher. Part of this change is due to the perceived (and likely realistic) greater risk present in areas outside of the top metros.

According to Hill, lenders are also looking for “properties with stable and predictable cash flow that are backed by historical performance.” Investors should have solid net worth and liquidity, and the site in question should be a quality asset in a strong location.

In terms of leverage, Swerdlin says that “65 percent is a safe bet; 70 percent is conceivable, but as you begin to push on leverage, you begin to see pricing affected.”

Experts agree that the availability of refinancing depends on the specific situation. Hill notes that lenders are more apt to refinance “if the existing debt is in line with current lending parameters (70 to 75 percent or less loan-to-value), and the deal has per-



*As of December 31, 2010; source: MBA

formed well through the downturn. However, if the property has experienced a disruption during the downturn, and if the leverage is now out of line with the current markets, then it is likely the borrower may need to inject cash to rebalance the deal; cash-in refinance is very popular right now. The difficulty comes when the borrower does not have access to the required equity.”

As an example, refinancing would be more difficult for a project bought at the height of the market in 2006 than a stabilized property built in 2003, according to Swerdlin.

“The difference compared to 16 months ago is that you can get close to the same interest rate. Some big deals are interest-only, but not all,” he says, adding that values have come back in the top MSAs, but pricing needs to be realistic.

Compared to other real estate sectors, self-storage has seen comparatively fewer defaults. In fact, according to Hill, in the CMBS sector, self-storage has the lowest default rates of all commercial property types.

“What that tells you is that once these properties are leased up, the cash flow is very resilient and the deals typically perform. Where the problems may have occurred is on the bank balance sheets, with deals that were on construction/mini perm loans because they were recently built and/or still leasing up prior to the recession. It is likely there are a number of these types of transactions that may have issues; however, since there are not really any meaningful data sources to compare these statistics to other asset classes, the depth of the problem is largely unknown. Empirically speaking, we have seen a lot of these transactions come through our office in the past couple of years,” Hill says.

Swerdlin agrees, noting that “As long as the owner has money in the deal, the banks are being fairly cooperative.”

Given the realities of today’s economy, the outlook for the availability of financing for acquisitions remains far more optimistic than that for development. Absent another major correction or recession, Hill states, “For those refinancing or acquiring existing, stabilized

facilities that are performing, I think the prospects are great. For well capitalized sponsors than can make equity investments into distressed transactions to re-balance them, I am also bullish. I am not as bullish on the development side; what we are seeing that is that if you have the wherewithal to build a deal for cash then you can probably get a loan, assuming the deal makes sense.”

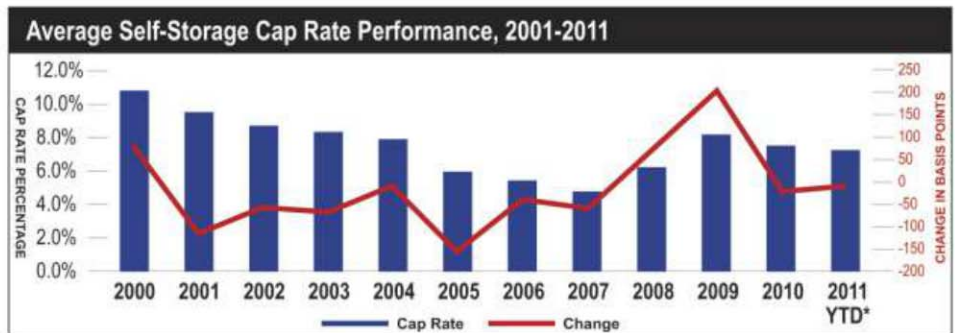
“Commercial real estate—aside from multifamily—was overbuilt, and we are now atoning for our development sins. Intellectually, I don’t see a compelling case for systematic development throughout the country,” Swerdlin says, adding that, of course, exceptions exist, especially in prime locations that are underserved. However, he

does not foresee banks being too enthusiastic about financing construction until substantial increases are made in employment, housing, and wages. “Developers,” he says, “will be willing to get in a lot sooner than banks will.”

In the meantime, Swerdlin says, “capital is going to continue to be there for big deals. There’s an excess amount of capital looking for yield, looking for deals.”



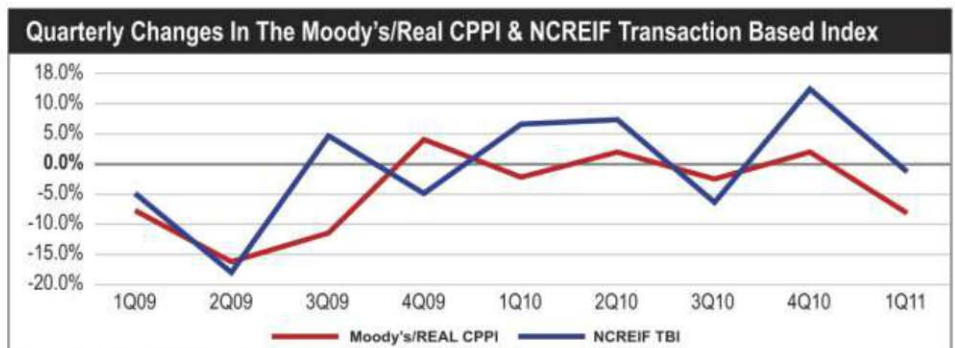
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Source: Holliday Fernoglio Fowler, LP

Quarter	CMBS (30+ days & REO)	Life Companies (60+ days)	Fannie Mae (60+ days)	Freddie Mac (60+ days)	Banks & Thrifts (60+ days)
1Q08	0.48%	0.01%	0.09%	0.04%	1.05%
1Q09	1.86%	0.12%	0.34%	0.12%	2.29%
1Q10	6.83%	0.31%	0.79%	0.22%	4.27%
1Q11	9.18%	0.14%	0.64%	0.36%	4.18%

Sources: MBA; Wachovia Capital Markets, LLC & Intex Solutions, Inc.; American Council of Life Insurers; Fannie Mae; Freddie Mac; OFHEO; and FDIC



Sources: MBA; Moody's Investor Services; MIT