



SELF STORAGE SALES NETWORK

Market Monitor

"America's Premier Self Storage Brokers"

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The Times Have Changed by Michael L. McCune

The Big Picture

Yes, there is a new sheriff in town! It is now abundantly clear that the so-called sub-prime mortgage debacle may be just the tip of the iceberg of the problems in the modern finance markets. Easy to obtain, cheap credit is the great lubricant that makes the engines of commerce really hum. Unfortunately the "easy to obtain" and "cheap" characteristics are the part of the formula that ultimately cause the credit system to break down. Credit availability is largely a function of the lender's confidence that they will be paid back with reasonable interest. Unfortunately, there are fewer institutions, or individuals, that find they have enough confidence in borrowers to lend money without what would have been significantly excessive guarantees or collateral just six months ago.

So What? I'm in the Self Storage Business!

Being in the self storage business also puts you square in the middle of the real estate business and thus, the value of your property and the financing are ruled by the valuations imposed by the real estate world. For the last four or five years this arrangement has been absolutely terrific for self storage owners as cap rates declined between 2.5% to 3.5%. Remember, as cap rates decline, values go up (Income/Cap Rates = Value). At the low end of the range, that means the value of the facility went up by about 37% during that time without any increase in income. If you kept your old loan (assuming 75% leverage), your equity shot up by 127%. But the story still gets better; at the same time cap rates were dropping, interest rates on loans declined by about 3% and the amount you could borrow went from 75% of value to 80% of value, maybe even more if you included the benefits of substantially looser underwriting. The combination of the value increase, lower interest rates and easier underwriting would mean that you could add about 50% to the amount of your loan and pay roughly the same amount of interest as before the refinance. All of this was available without any personal liability. The real estate business was very good to self storage owners over the last handful of years!

The Worm Turns

Starting last summer things began to change. The sub-prime market in residential real estate got very weak, the commercial loan folks said the loan-to-value ratios were out of whack and wanted the underwriting tightened up, then the big Wall Street Banks started taking big write downs. Today we find ourselves in quite a different spot than a year ago. Cap rates have gone up between 1.0% and 1.5%, causing values to decrease, but even worse, there are fewer buyers around. Despite the FED lowering short term rates, the spreads (the difference between the 10 year US Treasury rate and the interest rate) lenders charge for risk have almost tripled, leaving loan rates just slightly above where they were last year although still very reasonable in the context of a longer history. The bad news is that all of the Wall Street generated conduit loans are gone, and thus the life companies and banks can now get the exact terms they want and need from needy borrowers. Chart I shows what a difference a year makes! Steve Clifford of NorthMarq has prepared this information showing a hypothetical loan in 2007 and the comparable loan available today.

Chart I: Loan Comparison 2007-2008

Sample Project	Then: 2/07	Now: 2/08	+/-
NOI	\$200,000	\$200,000	
Amortization	30	25	
Rate	5.50%	7.00%	
Loan Amount	\$2,552,489	\$1,813,935	-29%
Loan to Value	80%	75%	
Cap Rate	7.00%	8.25%	
Value	\$2,857,143	\$2,424,242	-15%
Equity			
Required	\$304,654	\$610,308	+100%
Cash on Cash	8.56%	7.56%	

The bad news is that not only are loans harder for you to get, but they are also harder for your potential buyer to get. Even though the cap rates have gone up and thus the values down, the lower loan-to-value ratios means that the buyer still puts up about as much equity. This doesn't mean there are no buyers, there are still many, but they aren't quite as eager as before.

How Bad Is It? I don't think anyone knows, but the bad numbers keep getting bigger and are still coming from unexpected places. I have been in the real estate business 37 years and have seen three other major downturns in real estate, and this is by far the most wide spread problem yet!

When Will It Be Over? No one knows, but no one seriously thinks that it will be over quickly. Other commercial real estate performance is probably going to get worse and housing prices may still go down more.

What Do We Do? Check at the city offices for new building permits or plan approvals in your market. Give very serious thought to the potential of overbuilding. If a new facility causes your occupancy to go down by just 5% and your rents to go down by 5% (including rent concessions), your equity (assuming a 75% loan) will decline between 50% and 60%.

Additionally, if you don't have a loan with a fixed interest rate and at least five or six years left on the term: Refinance! Now! Get more term. Don't wait! If you are thinking about selling in the next three years and maybe even five years, sell now! Cap Rates will go up more (values down), if for no other reason than longer term interest rates will go up as investors will demand more return for their risk. Think about the value numbers in the first paragraph - but in reverse! **MM**