Time to Take a Look at the Big Picture

SELF STORAGE SALES NETWORK

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by Ben Vestal

2012 is a year that has been marked by the political "rock and roll" of the election season, and if you are like me, it is difficult to predict what the rest of the year or next year will bring. However, no matter what side of the aisle you sit on, if you consider the debt levels the US economy is embarking on with no debt reduction plan in place, it is obvious we are moving quickly in to uncharted waters. It is also important to mention that Congress has received warnings in regard to the US credit rating from groups such as Moody's; the same group we rely on to give us an unbiased opinion on our own investments. In light of the turmoil and uncertainty that our country is facing, I will give you two thoughts on the self storage real estate market that will hopefully provide some perspective for you to consider.

The Market for Self Storage Properties Today

The uncertainty of the economy, political leadership, interest rates and the current US tax structure have had an impact (either positive or negative) on the marketability of self storage properties around the county, depending on your current situation. However, unlike the macro issues mentioned above, the adjustments to self storage values have been more moderate and rational. Prices of self storage facilities per dollar of net operating income hit an absolute all time high in about mid-2007. Buyers at that time would accept the validity of just about any projection and would finance the project to the maximum allowed. The market of 2012 has seemingly found equilibrium at levels that are 5 to 15 percent below the historic highs; albeit the spread between the top 10 MSAs and the rest of the country is greater today than the market of 2007. This has created opportunities for the entrepreneur who can operate properties in smaller markets with a lower expense structure, employ more hands-on marketing, and utilize today's technology to minimize the expense load on a property. The reality is that most of the large deals done in major markets today are by investors and institutions with OPM (other people's money). These institutions also have access to less expensive capital than the entrepreneurial investor. The acquisitions for these institutional-type investors are not looked at the in same way as an entrepreneurial investor would evaluate an investment; i.e. protection of a current asset, protecting or gaining market share, the desire to enter certain markets or the opportunity cost of putting/or not putting the money to work today, just to name a few. All of this has led to a fluid transaction market today where deals are being done in both the large and small markets all around the county.

What is the Big Question Today?

The real question is; what do interest rates, improvement in the economy and a change in the current US tax structure mean for self storage owners and the values of their properties? In other words, how do changes in the macro economy and the credit markets impact the value of self storage properties and the owners' flexibility?

By example, capitalization rates (the way self storage and other commercial real estate is valued) and interest rates are inexorably linked. If interest rates go up, cap rates will ultimately go up as well, and vice versa. However, due to various market conditions, the link between the two is somewhat flexible as to the timing and magnitude. Think about the relationship between the two rates as being tied together by a rubber band that allows the relationship to expand and contract somewhat, but the overall relationship remains very strong and closely related. The current low interest rate environment has allowed the market to reach equilibrium and created an almost perfect environment for anyone thinking of buying, selling or refinancing! I know that sounds like a broker talking but consider the following: Buyers can buy a great property and achieve cash on cash returns not seen in many years, Sellers today on the other hand can get near the highest price per dollar of income in the history of self storage, and if you are considering refinancing you can lock in an interest rate at the lowest rate in 50 years. *The real question is how long will this all last?*

Secondly, the values of self storage properties will most likely stay relatively the same in the coming year if the economy continues to improve. It is anticipated that we will experience a 10 to 25 basis point compression in cap rates over the next year. This is largely due to the current interest rate environment with most of this compression in cap rates being enjoyed by the “B” and “C” class properties as investors continue to chase yield. However, we just as easily could see a 10 to 25 basis point expansion in cap rates if we were to experience an increase in interest rates after the election.

Lastly, a change in the US tax structure could be devastating to the after-tax dollars a seller will receive when selling a self storage property. Not because the properties will be producing any less income than the year before or the value of the property will be less than today. I am not an accountant and do not give tax advice, but I believe it is worth your time to check with your accountant to understand the impacts of an increase in capital gains tax on your after-tax proceeds.

Clearly, any of these events could have a material impact on a buyer’s or seller’s investment. My best advice is that if you are in the market today it is time to seize the moment!