

Acquisitions... Still Few and Far Between

Deals can happen, but cash is king.

By Mark Wright

Tight credit, uncertainty about pricing, and recessionary consumer behavior have many potential self storage deal makers sitting on their hands—and their wallets.

“The transactions we’re seeing are smaller transactions in smaller markets where the local bank knows the borrower,” says Ken Nitzberg, chairman and CEO of Emeryville, California-based Devon Self Storage Holdings (US) LLC. “National scale, bigger transactions are not participating—they’re gone.”

Aaron Swerdlin, senior managing director of Houston, Texas-based Holliday Fenoglio Fowler, L.P., says there is a “whole slew of people waiting on the sidelines for distressed deals—and they’ll be waiting for quite awhile, because it doesn’t seem like many deals are coming to market.”

Reticent Lenders

The tight credit market is no secret. Even those banks kept afloat by taxpayer dollars seem to have forgotten the old saying, “A ship in a harbor is safe, but that is not what ships are built for.” Some bankers might have slept better following Uncle Sam’s high-profile bailouts, but their waking hours have not been devoted to parting with much money.

“Lenders are becoming more hesitant to lend, because they have more assets on their balance sheets and they’re having trouble determining value,” explains Neal Gussis, principal of Chicago, Illinois-based Beacon Capital Realty. “They don’t want to make a loan when they think value is deteriorating further. The larger banks don’t want to put their money at risk.”

Gussis says the real issue is leverage. “The fear is that interest rates will rise. If they do and leverage stays the same, then people will be in a worse position than today. Even if liquidity comes back the standards could erode further.”

Nitzberg describes lending as “so restricted as to be almost nonexistent. You might be able to get 50 to 60 percent loans on capitalizing NOI (net operating income). No lender will give you credit on unrented space.”



Moreover, lenders today want full recourse loans, a big change from the nonrecourse loans self storage has historically enjoyed. That, combined with putting up 35 to 50 percent of the purchase price sought by lenders in this environment, “drastically” changes the landscape for buyers, he notes.

Gussis anticipates that over time, owners might be forced to sell their property in some circumstances because of the lender’s lack of willingness to modify or extend the loan. He sees today’s changes as part of a long-term correction. “The best people could do is manage their revenue stream as best they can,” he says, “which is hard in a recessionary period because we’re used to increasing rents.”

Uncertain Valuations

In addition, says Nitzberg, there is a gap between what the typical seller thinks his property is worth versus what the typical buyer is willing to pay. “Buyers are saying, ‘I’ll only pay you some cap rate on the existing income actually in place, not on any future income,’” he adds, so “the buyer’s

See Acquisitions, page 10

bar has been raised and the seller's hasn't been lowered. We have to get them to match."

The lack of deals compounds the challenge of coming up with prices. "People aren't really certain, because there haven't been enough transactions to know what the market is," says Tony Rider, CFO of Buffalo, New York-based Locke Acquisition Group. "Owners that can hold are not sellers."

Rider sees some hopeful signs, however, that prices are firming up in solid markets that are decent-sized and have some stability in their populations and economies. He says owners in stabilized markets who need to sell for whatever reason can do it, although selling in markets "that got ahead of themselves" is harder.

Rider notes that unusual lending arrangements can complicate the valuation task. "Properties in lease-up where lenders made loans of some sort, such as a short construction loan or some kind of bridge loan—those are very difficult to value."

All the uncertainty is resulting in a wide spread of values, he says, "because everybody's got to take a guess. Some people who might be interested are risk adjusting them severely, but some more than others. On stabilized properties the value gap doesn't seem to be that difficult to bridge."

Generally, the better properties are the ones that can see some activity. Older properties in small, tertiary markets are not moving, Rider says, but class-A facilities generating good cash flow in stabilized markets have a chance.

"There's no shortage of capital looking for deals," says Swerdlin, "there's a shortage of data points on whether people are paying the right price. They just don't want to make a multimillion dollar mistake. As people understand how deals are being priced, we'll begin to see more activity. Real estate's about data and comps and there's very little of either right now."

Cash Equals Opportunity

With lenders clamping down, potential deal makers who need not knock on bankers' doors have more room to maneuver. Gussis observes that, "People with cash in this market will be in a significantly better position."






Being cash-rich is apparently not a common condition right now, though. "Cash buyers are few and far between," says Nitzberg.

One such buyer is nonetheless happily seeking deals despite the cloud-filled sky.

"We're active and a cash buyer and require no financing," says Wayne Johnson, senior VP of acquisitions with Ladera Ranch, California-based Strategic Storage Trust, Inc. "We're probably one of the only cash buyers right now."

See Acquisitions, page 13

MILLER
Your System for Building Success!

 **MULTI-STORY**
 **SINGLE STORY**
 **SPLIT LEVEL**
 **CONVERSION**
 **RELOCATABLE**

Price Purchase experience at the best available price. Miller delivers excellence on-budget

Quality Exceptional quality & reliable installation with over 30 years of experience

Service Your single source for design, supply & installation

MILLER YOUR SYSTEM FOR BUILDING SUCCESS

Quick Quotes: Call Now 1-800-323-6464... or visit www.millerbldgs.com

We're all about locating yield on performing assets. We are looking in all the major markets."

Johnson says the non-traded REIT recently closed two transactions in suburban locations around Atlanta. "Those were two deals that were well-occupied, stable and all cash," he explains. "These are class-A properties in class-A locations, and that's the kind of product we want to buy."

Such cherry picking is no easy task these days, however, given the macro economic doldrums. "We think the occupied market will be flat in the near term," Johnson adds. "Hopefully economic occupancies will rise as we get through the recession."

Another upbeat buyer is Stephen Kaplan, CEO of San Diego, California-based Equity Based Services, Inc. "In my 20-year career, we're in the middle of the best period to acquire self storage," he says. "For groups like ours that have access to equity and the ability to finance debt, there is no better time to buy self storage. The nature of financing has changed quite a bit, but it is still available in abundance to credible buyers."

While he acknowledges the difficulties of banks pulling back on leveraging and on nonrecourse loans, and eschewing interest-only terms, he says those are not the most important factors. "The key is the credit worthiness of the borrower and the borrower's ability to demonstrate a proven track record of self storage management," says Kaplan. "A mom and pop operation would have a tough time right now convincing a bank to lend on their very first project."

Looking Forward

The trickle of transactions isn't necessarily a negative sign, some say. "Because we don't see a huge volume of transactions, that's a good indication a lot of operators out there are comfortable with the cash flow," observes Swerdlin. "And in spite of all the conjecture of real estate values staying down, people are not seeing a necessity to modify cash flow."

Kaplan sees history as a helpful guide to what's likely in store: "Just looking at my 20 years, I've seen the conduit lending market fall apart twice. When it happens, it's 24 to 36 months before the wheels start turning again. Lenders will again start lending at 9 percent for 20 years, then 8 percent for 25 years, then (the rate) just starts creeping down."

A lending turnaround is vital, says Nitzberg: "The debt market is the raw material for the transaction market. The problem was we were using rocket fuel instead of gasoline the last few years and people started to believe that was normal. Now, they're shell shocked—because it wasn't."

Both Swerdlin and Kaplan note that self storage has the lowest default rate—and has performed better—compared with other real estate product types. But Kaplan and Nitzberg also say that overbuilding has been a problem.

"This shake-up is kind of good in a way," says Kaplan, "because it allows the extra inventory to be rented up and absorbed."

"The good news is, self storage operationally will weather this quite well," predicts Swerdlin. "The bad news is, real estate values will have quite a ways to go before pricing catches up to value." ❖

