

Debt Maturity Likely to Create Refinancing Headaches

Watch out for equity problems over next two years.

By Laura Williams-Tracy

Though economists say the recession may be lifting, the commercial real estate industry is bracing for more hard times ahead. There's a blitz of hundreds of billions of dollars in maturing loans—many in self storage—that will need to be recapitalized in the harshest of market conditions.

“The debt maturity issue for self storage owners is probably the most important single issue facing self storage and commercial property owners, assuming that their property or portfolio occupancy hasn't declined dramatically,” says Jim Davies, a principal with Davies Ingersoll Capital Partners in Newport Beach, California. Property owners with loan terms coming due over the next 12 to 24 months could be caught unable to generate enough loan proceeds to cover the existing debt on their storage facility, requiring them to put thousands or millions of new equity in their properties.

Problems Simmered for Years

Self storage, and other commercial property types, got to this point after years of weakening underwriting quality, compressed cap rates and ballooning leverage, which led to rapidly rising commercial real estate prices. In 2007, the commercial real estate bubble burst. Last year revealed just how weak the banking system had become under highly leveraged, over-valued properties. The next two years are likely to bring fallout to owners who must renegotiate.

“If you have to refinance, your equity will probably be wiped out,” says Neal Gussis, a principal with Beacon Realty Capital, Inc. in Chicago. “Your loan amount is going to be more than the property is worth.”

Those who are breathing easiest are owners who don't have any loans coming due in the next four to five years. But those who must refinance in 2010 or 2011 face a challenge that depends on how leveraged their properties are. While the industry is market specific, in some areas commercial properties have lost 30 to 40 percent of their value.

The scope of the problem is huge. Within the entire commercial market, \$160 billion in assets face new loan terms; \$176 billion in 2011, Gussis says. Of that, 1.5 percent of the debt pool is self storage properties, for a total of about \$2.5 billion coming due for refinancing next year.

Davies says even owners with low vacancy rates and strong financial performance may need to find an investor to help them secure new financing.

“The lending market for self storage, which is a mere pittance of what it was 24 months ago, is very fragmented,” he says. “There is no consistency or homogeneity in the programs that are being offered except that borrowers are generally finding that they must live with less loan proceeds, more recourse and shorter loan terms.”

Davies says the cap rate that lenders will use to value property is going to be a couple of percentage points higher than what the same lender was accepting 24 months ago. Likewise, the loans-to-value parameter used by most lenders today is in the 50 to 65 percent range instead of the more aggressive 80 percent of value used just 18 to 24 months ago.

More properties are going to change hands as more property owners feel the pressures of refinancing.

Investor Bargains Coming? Maybe.

Eventually, that could mean bargains for well-capitalized investors. But so far those distressed properties have not appeared in great numbers on the market as some investors had predicted.

“Generally, banks are extending loans when they come due,” Davies says, which has kept many troubled properties in owners' hands. That's just as well. Most buyers, afraid of overpaying in an uncertain market, are on the sidelines waiting for prices to drop further.

The gap in price between buyers and sellers means deals are scarce. And in such a challenging market, few owners want more risk.

The good news, Gussis says, is that most self storage deals tend to be in the \$2 to \$5 million range, a smaller loan size that is more attractive to the small to mid-size banks that are still making loans.

“In today's market that turns out to be an advantage,” Gussis says. “Self storage is faring better than all other property types. We're not as ugly as the other ugly.” ❖