SpareFoot Storage Beat

Capital spigot still open for new storage construction in 2017

APRIL 17, 2017 -- Capital has been greasing the wheels of the recent self-storage building boom. And despite some signs of tightening, there appears to be ample financing available to keep that momentum going in the near term.

“There is still plenty of capital for the right deal that makes sense and for the right sponsors,” said Griffin Guthnick, a senior vice president in the **Real Estate Investment Banking group at JLL**.

That being said, it is not all business as usual. There has been a noticeable pullback over the past 24 months from some of the large bank lenders due to tighter banking regulations, he adds.
Most of the construction loans that JLL has secured for its self-storage clients over the past two years have been with local and regional banks as national banks have become more conservative on their construction financing.

For example, JLL recently secured a five-year, non-recourse construction loan from a regional bank for SurePoint Self Storage. The company is planning to build a 91,950-square-foot facility with 726 units of climate-controlled and non-climate-controlled storage in the Houston suburb of Pearland.

Take it to the bank

Banks are still providing the majority of construction financing for both ground-up and conversion projects. Smaller operators are mostly utilizing regional banks and local banks to build their projects.

“Larger operators with full pipelines focused on nationwide development are opting for money center banks that will follow them around the country or regional banks who can work nationally,” said Eric Snyder, a principal of **Talonvest Capital Inc.**, a boutique self-storage and commercial real estate advisory firm.

Talonvest structures and negotiates construction loans, and the firm also has arranged approximately $34 million on JV equity for storage developments during this development cycle.

However, banks have become more selective on commercial real estate construction loans across the board due to the implementation of Dodd-Frank and Basel III regulations. The new rules create higher reserve requirements for bank lenders specific to high volatility commercial real estate (HVCRE) loans, which generally include real estate construction loans.

“Walk before they run”

Lenders also are keeping a close eye on the supply and demand given the surge in development activity in recent years.

“A lot of lenders are being somewhat selective with regards to the sites, because of threats of new supply. Also, you have some economy related components depending on the individual market,” said Guthnick.

Bank lenders are choosing to work with seasoned sponsors who have successfully progressed through the cycle of development, lease-up and stabilization on multiple properties. Some banks also like to work with developers who have successfully managed at least one development through the Great Recession, says Jim Davies, a principal at Talonvest Capital.

One trend that has become more common is that even large money center banks with significant lending capacity are making a concerted effort to “walk before they run” with a new client, says Davies. For example, the bank may only want to fund a limited number of deals in a developer’s entire pipeline.

“They will then want to see these properties achieve some level of success, in terms of hitting their budgets and lease-up projections, before they fund another project for the borrower-developer,” Davies said.

The result is that a developer with a strong pipeline of development projects will most likely need to use multiple banks to achieve their construction funding goals, he adds.

Stricter standards

Banks also have been slowly reducing leverage and requiring more equity from self-storage developers and their investors.

“It is becoming more difficult to find 75% loan-to-cost as banks are more comfortable in the 65% to 70% range,” said Snyder.

However, the lower leverage frequently comes with lower levels of recourse. It is typical for banks to start off with only a 50% recourse requirement at 65% loan-to-cost. As the property starts to lease up, banks may reduce recourse as the project reaches certain hurdles, ultimately evolving into a non-recourse loan, he says.

Borrowers often prefer non-recourse construction financing, which is more difficult to facilitate and harder to find, adds Guthnick. There is a much smaller group of bank lenders that are comfortable with non-recourse lending. The banks that are willing to provide non-recourse loans typically offer lower leverage, perhaps 10 to 15% less on loan-to-cost compared to a typical recourse construction loan and also require a completion guarantee, he says.

Specialty lenders

In addition to the banks, there are other lenders that are stepping up to provide both debt and equity for self-storage construction financing, including large credit unions, private equity funds, life insurance companies and REITs.

For example, Jernigan Capital, a REIT that specializes in providing financing to the self-storage industry has said that it has closed on $105.6 million in new development investments in the first 60 days of 2017.

“There have been some other new players that have entered the market in the last couple of years that are stepping up to fill some of that void,” said Guthnick.

About Beth Matson-Teig

Beth Mattson-Teig is a freelance business writer and editor in Minneapolis, MN. She specializes in commercial real estate and finance topics, and writes for several national trade publications and business journals.