SpareFoot Storage Beat

Self-storage lenders become “risk aware”

by John Egan on June 26, 2017

Money to build new storage facilities is still available, but may be harder to come by for some.

Construction financing that commercial real estate advisory firm Talonvest Capital Inc. recently arranged for two big players in self-storage is a sign of the changing financial times.

Tom Sherlock, principal of Talonvest, said the seven construction loans Talonvest obtained for The William Warren Group and Metro Self Storage — four loans for William Warren and three for Metro — came from four banks. Just a year ago, those $61.9 million in loans could have been secured from one or two banks, he said.

Why the need to go to four banks versus one or two? Sherlock said banks now are more “risk aware” when it comes to construction loans for self-storage developers than they were last year.

Today, lenders are “cherry-picking” which self-storage developers will be able to gain construction financing, according to Sherlock.

“They’re making loans that are less aggressive than they were a year ago,” he told the SpareFoot Storage Beat, “and the pricing on those loans is more expensive than it was a year ago.”

Tightening the reigns

In 2016, a variety of banks would have offered non-recourse, self-storage construction loans at 65 percent leverage, Sherlock said. Only a year later, the number of banks offering non-recourse, self-storage construction loans has decreased, and the leverage levels have fallen to anywhere from 50 percent to 60 percent, he said.

Additionally, pricing on self-construction loans has gone from LIBOR plus mid- to high 200s to a less desirable LIBOR plus low to mid-300s, Sherlock said.

As a result of all that, the “risk-reward profile” for self-storage developers has shifted, he said. Either a developer must settle for less return at the same risk level compared with a year ago, Sherlock said, or assume more risk to achieve the same level of return.

“It’s forcing some discipline into the market,” he said. “The experienced, sophisticated, larger developers will still get financed. But the ones with less experience, less knowledge, less sophistication are definitely having a harder time finding capital.”

What's behind these changes?

Sherlock cites two reasons:

- Bank regulators are scrutinizing banks' loan portfolios more carefully. "They're being more stringent in how they evaluate construction loans, in particular, on the bank's balance sheet," he said.
- Inside banks, credit officers — the ones who ensure a bank's credit standards are being met — have captured more power than loan originators, who bring financing deals to the table.

Despite the strict lending environment, Sherlock said Talonvest's lending pipeline for self-storage is "very strong," with the firm seeing more interest in construction, value-add and certificate-of-occupancy loans. In the past two years, Talonvest has closed about $800 million in self-storage loans.

Sherlock said Talonvest's self-storage lending pipeline is full — in large part because it caters to financing for private developers with deep experience in the industry.

Room to grow

That deep experience certainly is evident with William Warren, which got $37.8 million in construction loans negotiated by Talonvest, and Metro Self Storage, which got $24.1 million in construction loans negotiated by Talonvest.

With its financing, William Warren will develop about 310,000 square feet of facilities in Southern California's Los Angeles, San Diego and Orange counties, as well as in Scottsdale, AZ. Meanwhile, Metro will develop more than 236,000 square feet of facilities in Chadds Ford, PA, and Naperville and Addison, IL.