STORAGE FINACE STRATEGIES

By Scott Sweeney | Business Development Office | Talonvest Capital. Inc.
ssweeney@talonvest.com

With capital markets and financing strategies, is it Déjà vu all over again? As Yogi Berra might have said "perhaps, though not exactly," and while history tends to repeat itself, financial markets notoriously throw curve balls.

Retired Yale physics professor Robert Adair noted in his book, *The Physics of Baseball*, that the ball and bat collision only lasts 1/1000th of a second. Your financial reaction timing need not be as quick as that of a professional baseball hitter, yet choosing the right financing option is very much like the required skill and situational awareness used by a batter when selecting the best pitch. Let's look at a few financing strategies based on the current market.

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While capital markets continue to deliver interest rates at or near historic lows, most agree rates will eventually increase. If you are seeking acquisition or recapitalization financing now, your market timing is very good. For quality self storage assets combined with strong sponsorship, lenders will compete for your business with a multitude of aggressive loan terms in today's market.

Here are some general terms to consider while getting settled in the batter's box.

Commercial mortgage backed securitized (CMBS) non-recourse loan-to-value (LTV) ratios are often capped at 70%-75% for stabilized storage properties on loans having a fixed rate. Term length for 5, 7, or 10 year periods and having up to a 30 year amortization schedule, are typical. Interest only periods are available and select lenders will entertain full-term interest only schedules at lower LTV levels. At 75% LTV, debt service coverage ratios at or above a 1.30-1.40 to 1.00 level combined with debt yields greater than 8.25%-8.50% are key to securing the best available rates. Your rate is locked prior to loan funding. To justify transaction costs, CMBS loan amounts generally need to be greater than $2 million.

Life companies are another fixed rate, non-recourse lending source with many offering a maximum of 65%-70% LTV on self storage properties. Historically and when carrying loans on their books, life companies' loan underwriting tends to be more conservative than CMBS underwriting. Life companies will rate lock at loan application acceptance after their initial thorough underwriting process is completed. Terms up to 20, 25, and in some instances 30 years along with options for fully amortizing loan structures can be realized. On a case-by-case basis, these lenders may also offer flexible structure options including earn-outs, collateral releases, and recourse burn-offs which are particularly important considerations with a portfolio financing requirement including multiple storage assets. Though select life companies may offer loans at less than $4-$5 million, more life companies will compete for your business on larger loans of $5-$10 million or greater.

(Continued from page 12)

Balance sheet lenders will typically seek larger loan amounts of $10 million or greater for single assets and even higher for portfolios. Non-recourse options are generally available at 60% LTV or less and with partial or full recourse at greater leverage.

Traditional bank and credit union financing are two additional options to consider. Recourse loans are the norm with a broad range of loan term length and amortization options. Floating and fixed-to-floating rates are typical. Options to fix a floating rate include swaps, caps, or collars and it's recommended that you discuss these strategies with mortgage brokerage professionals.

With CMBS and life company loans, prepayment is going to be limited to defeasance or yield maintenance. Whereas with balance sheet, bank, and credit union financing a predetermined exit fee is often calculated based on the year in which the loan is prepaid.

Be careful of the wild pitch. Ultimately, your loan amount will boil down to several key items. LTV, DSCR, debt yield, and cap rate. Some borrowers are surprised when learning that lenders will generally want to see a management fee expense near 5%-6% of your effective gross income. Lenders will typically underwrite a capital expense replacement reserve minimum close to $0.15 per square foot, or a higher amount if recommended through the engineering report. On the real estate tax side, appraisers will closely evaluate your current property taxes while stressing a forward look meaning their forecast will include adjustments for property taxes after an ownership transfer due to a sale, partnership structure changes, or a loan default. These adjustments may effectively reduce your net operating income below your expectations.

Play ball, and it's recommended that you discuss your financing requirements with a lending professional to guide you through the process and to assist in sourcing the best solution.