July 20, 2011

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REO Sales Fueling Buyer Interest in Self Storage Properties

REITs and Other Investors Looks At Sun Belt Markets For Deals As Banks Move Distressed Properties Off Their Books

Mirroring the choppy recovery in the broader economy, self-storage real estate will see an increase in investor activity in the second half of 2011 as banks sell off distressed assets throughout the Sun Belt, particularly in California and Florida, according to a new report from Marcus & Millichap.

As it is across all types of commercial property, the number of investment sales transactions is trending upward in self-storage, which occupies a tiny niche within the $14 billion industrial sales market. The first six months of 2011 saw 247 sold transactions, up from 200 in the same period last year, according to preliminary CoStar sales data.

Dollar volume has increased from $173 million in the first half of last year to a preliminary $273.7 million through June 30, 2011, while the median price per square foot has steadily edged up since hitting a cyclical low of $28.89 in early 2010. The median price per square foot rose to $35.68 in the second quarter.

"Self storage has taken its lumps just like every other product type, but overall the sector has held up very, very well over the last three or four years," Eric Snyder, principal with Costa Mesa, CA-based TalonVest Capital Inc., tells CoStar.

TalonVest recently closed $20 million in fixed-rate non-recourse permanent loans in separate transactions for two California-based self-storage operators.

"In a good economy, there’s demand for self storage, and in a bad economy, there’s demand for self storage. Most properties that were stabilized going into the downturn haven’t taken significant hits on NOI."

As with other property categories, Class A assets in top markets will garner the most attention from buyers, with initial yields in the mid-7% to low-8% range depending on their location and age, according to Marcus & Millichap's mid-year outlook. Urban infill locations -- especially those near high-density retail centers, since most storage facilities get half of their business from drive-by traffic -- are most coveted by investors.

"We’re seeing prime-of-the-prime properties in those locations trade at 6 ½ caps," said Snyder, who along with TalonVest principal Jim Davies, previously headed real estate investment bank Buchanan Street Partners' storage capital business.

The pair has been involved in some $3.5 billion in debt, equity, conduit and other capitalizations of self storage properties throughout the country. Snyder and Thomas Sherlock left Newport Beach, CA-based Buchanan Street last year to found TalonVest, and they were joined this year by Davies.

However, distress is expected to be a major factor in the expected upswing in transactions. Marcus & Millichap forecasts that opportunistic regional syndicates will zero in on a growing number of Class B and C properties becoming available through REO sales in non-core housing bust markets, where banks have been reluctant to refinance loans coming due on devalued assets, pushing more properties into foreclosure.

Because of improving fundamentals, owners of stabilized storage properties have found banks willing to work with them by extending loans or waiving pre-payment penalties, even if they're a bit underwater, Snyder said. However, many facilities built during 2006 to 2008 still have an overhang of construction debt conditioned upon aggressive three-year lease-up plans.

Even though many storage facilities are seeing a slow-but-steady increase in absorption amid a dwindling supply of units, banks are cutting their losses and foreclosing on lesser-performing properties in secondary locations.

Even owners of some non-core properties are now able to refinance via the new CMBS (commercial mortgage-backed securities) loan programs, however. Such transactions would not have been possible 12 months ago, at least on a non-recourse basis, Snyder said.

"Many more lenders are willing to do smaller loans in more secondary locations, and that is a good thing for the self storage industry," he said.

Marcus & Millichap forecasts that the lower end of the market will accelerate, with new buyers finding Small Business Administration (SBA) financing for performing properties selling at less than $5 million. Well-capitalized publicly traded and private REITs and institutions, along with private-equity investors, smaller owner-operators and lenders, are also moving back into the arena to provide debt and equity.

The year has seen a number of large self-storage portfolio transactions, which the largest being the $86 million purchase of 24 properties in California, Illinois and Hawaii, totaling 1.6 million square feet. New York-based CPA:17 - Global, a publicly held nontraded REIT affiliate of W.P. Carey & Co. bought the portfolio from A-American Self Storage Management Co. Inc. in a deal that closed in June. Charles LeClaire, senior director, National Self-Storage Group for Marcus & Millichap in Denver, represented the buyer and seller. Elizabeth Raun Schlesinger, a W.P. Carey director, worked on the deal and Reed Smith LLP represented CPA:17 as general real estate and transaction counsel.

Other large purchases include the $44 million acquisition of an 11-property portfolio totaling 820,700 square feet in Georgia, New York and Virginia by Strategic Storage Trust Inc., which closed June 10.

Strategic Trust also bought 11 properties totaling 791,000 square feet in Texas, Georgia, North Carolina and South Carolina from USA Self Storage in a separate deal last quarter for $27.7 million.