SELF STORAGE MONTHLY

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The Self Storage Home Study Course includes a manual with your 30 days of due diligence that will teach you how to BUY, SELL, OPERATE, AND TURNAROUND any Self Storage Facility.

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Memo From Frank & Dave

We are seeing more attractive pricing on many deals, due to foreclosure and a return to realistic pricing on the part of banks and sellers who now favor actually getting deals done over waiting for a sucker to come along. Some facilities are selling for a fraction of construction cost, particularly in formerly hot areas such as California. The moral from all this is that self-storage facilities are an *income property* and should be valued only on *income*. Future land speculation values and hitting occupancy that has never been achieved should not be part of your value calculation. That's what got the sellers in trouble to begin with. If everyone holds to the concept of demanding that the self-storage facility have a track record of financial performance - and value it based on that track record - then the industry should never get in this mess again. But lenders as well as borrowers need to stay diligent on reasonable appraisals and values. People will buy $2 for $1, they'll even buy $2 for $2, but nobody is going to buy $1 for $2, regardless of what the perception of future values are.

THE MANY WAYS TO FINANCE A SELF-STORAGE FACILITY

One of the benefits to self-storage facilities – and all forms of commercial real estate – is leverage. Leverage allows you to have significantly higher cash-on-cash returns, as the interest rate on most loans is lower than the overall cap rate of the self-storage facility. For example, a self-storage facility purchased at a 9% cap rate will have, assuming a 70% loan-to-value at 6% interest, a cash-on-cash return of 16%. So clearly, sensible leverage is a good thing, allowing you to have higher yields and buy more property than you could with all-cash. So how do you get the financing on a self-storage facility? There are many options to consider:

Traditional Bank Debt

The initial building block for most investors is the good, old-fashioned loan from a bank. These are normally around 70% to 80% of appraised value with a 5 year term and a variable interest rate right now of around 6% to 7%. These loans are recourse loans, in which the borrower is personally liable if anything should go wrong. You will find that banks come in two basic categories: 1) local and regional banks, which are smaller and more entrepreneurial and 2) national banks, which are more difficult to work with but can make larger loans.

Conduit Debt

These are more advanced loans, which are sold to the public (also known as CMBS which stands for "Commercial Mortgage-Backed Securities). Conduit loans, which are originated through such institutions as Citigroup, offer the same basic structure as traditional bank loans, except for some significant advantages including: 1) a fixed interest rate 2) non-recourse 3) 10-year term. The downside is that the loan amount must be in excess of $1 million (most prefer $2 million), the borrower must go under even greater scrutiny and liquidity requirements, the costs associated with the loan are greater (legal, survey, etc.) and the loans take longer to complete. But for many borrowers, you cannot beat the appeal of conduit debt.

Private lending

There are groups that make loans that are not traditional banks. These groups can be extremely important on facilities that require significant turn-around before they can support traditional bank or conduit debt. These sources can also provide interim financing – the bridge between the purchase and obtaining traditional debt. The downside to private lending is a higher interest rate, even shorter term, and the fact that they are not governed by federal banking laws and rules on behavior (some people call private lending practices "loan to own", which means that they can sometimes be much tougher on collections and loan defaults than traditional banks).

Seller financing

This is one of the best forms of financing for a self-storage facility. Seller financing (also known as seller carry) features lower down-payments, lower interest rates and often longer loan terms than traditional bank and conduit debt. Seller financing is almost always non-recourse. There is virtually no credit check or screening of any type. Many a large portfolio owner began with a seller-carry note to get them in the door.

Individuals

In a world of 1% CD rates, there are wealthy individuals who now make commercial real estate loans to boost their investment yields. These are, however, relatively rare and difficult to find. But it's a concept that's worth mentioning, because you will probably be seeing more of this in the future as people investigate new methods to increase their IRA yields, through a concept called "Self-Directed IRA". By converting to a SDIRA (which costs around $500), a whole new arena of investment options open up, which would include financing a self-storage facility (but consult a professional for advice). Since IRAs cannot be used until retirement, which is often years or decades off, SDIRAs are patient money and would be ideal for creation of such loans.

The case for all-cash

With all this talk of financing, you'd think that there's something wrong with buying a self-storage facility for all cash. There's not. In fact, all-cash buyers get to escape many hazards including the whole cost and aggravation of bank financing, as well as loan default and bank failure. There are two downsides to buying for cash. One is that your yield will be reduced (see the example on cash-on-cash leverage from above) and the other is that you will lack the additional scrutiny a bank provides. Although buyers don't often like to be told "no", sometimes that additional opinion from the bank and its appraiser can save the day, and identify flaws that the buyer missed.

Conclusion

There are many options to create leverage for a self-storage facility, and all of these will increase the return on your investment. Explore the possibilities, get educated on the pros and cons, and pick the right option for your purchase.