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SERVING: THE NORTHEASTERN AND MID-ATLANTIC STATES

HOW LONG WILL THE "WINDOW" REMAIN OPEN?

by John E. Barry

If you are a self storage owner, loan rates are still extremely favorable for acquisition and refinancing, but may not be for long. We have seen interest rates drop from over 15% in the early 1980s to as low as 4% in recent years. Today, you can still obtain long term bank loan financing for around 7.2% or conduit financing for around 6.8%, so we remain on the low end of historical interest rates. The momentum is changing, however, as they have started to rise in recent months.

The Federal Reserve Board who monitors and sets benchmark interest rates is concerned about oil prices, inflation, and the reduction in foreign governments buying US Treasury debt. Chances are excellent that rates will creep even higher than today's rate. So today's rate may look cheap over the next 10 years.

What should you do?

Incurring or increasing debt is no small decision. As an owner, you should first determine specifically what your short term and long term goals really are. If they are short term and include selling your facility to enjoy retirement or pursue other interests, then now is an excellent time to sell as it is a seller's market and capital gains rates are only 15%. If your goals are longer term, then you should see if any refinancing alternatives make sense for you.

Debt refinancing in most business structures can provide tax free access to the built-up equity in your property while you maintain ownership, keep some equity in the property, retain cash flow, and enjoy future appreciation. You can put the equity to work in acquiring or developing another facility or putting the cash into another asset class. Remember, for each \$1 of equity you access you can produce \$4 of assets in another property. Refinancing also eliminates future interest rate risk and lowers your monthly costs, which in turn, increases your cash flow.

Bank Loans

While banks or portfolio lenders will provide refinancing options, you will need to provide personal guarantees, and the rates they offer will be higher than through conduit loans.

Conduit Loans

With a conduit loan, your self storage loan would be combined with other similar loans, packaged into a single loan, and sold to investors as a bond or Wall Street security called a collateralized mortgage backed security (CMBS). Let's focus on what the conduit loan market offers.

Basic Conduit Loan Characteristics

- Minimum loan amount is \$1,000,000 although sometimes higher
- Loan process takes between 45-60 days
- Loan rates are priced at a spread above the 10-year treasury bond, usually between 1.5% to 2.2% depending upon the current market and the individual credit
- Loans are offered on stabilized properties with most amenities. Properties that require significant lease up, are rural, or lack fencing, paving, or have a poor operating history usually do not qualify
- 75-80% loan to value ratio. Fixed terms between 5-10 years with amortization period up to 30 years

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Advantages (to the Conduit Loan)

- Rates offered for fixed term of 10 years cannot be matched by banks
- Amortization periods up to 30 years are not offered by banks
- Lock in your interest rate anytime during the loan process
- Non recourse loan means lender would foreclose on the property, not on personal assets
Personal assets at risk only if borrower committed fraud in misrepresenting environmental or property issues

Disadvantages (to the Conduit Loan)

- High prepayment penalties so plan on holding the asset over the term
- No second mortgages are permitted
- Require escrowed property taxes and insurance
- Require monthly deposits into a capital reserve fund
- Require higher liability insurance and additional coverage
Require third party reports on property condition

Like anything worthwhile, conduit loans require some work on the part of the borrower to meet the strict underwriting guidelines. On the other hand, if you plan to hold on to your property for many years, the interest rate environment is still very favorable and you might look back in a few years smiling at the rate you locked in today. ■

**Investment Real Estate helps their clients when they need to turn to the conduit financing market.
Call us for further information.**