ARGUS
SELF STORAGE SALES NETWORK

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Opportunities in the Market Today...
Are You Taking Advantage of Them?

by Ben Vestal

In my recent conversations with self-storage owners, I have noticed that the majority are enjoying stabilizing revenues, and in some cases they are also enjoying an increase in revenue over the last 6 to 12 months. Interestingly, most owners don't realize that they have made or lost money because they are in the real estate business and not the self-storage business. While the increase in revenue is creating more cash flow for owners, today the real opportunity lies in the arbitrage that a real estate investor can capitalize on between cap rates and interest rates. Arbitrage is usually thought of as a high finance concept but there are some viable opportunities that might be available in the world of self-storage. The term arbitrage means that an investor can take advantage of some pricing or other discrepancies in the marketplace.

As we know, cap rates are, in the simplest form, a return that a buyer demands on the investment in a property without taking leverage into consideration. For example, if a buyer is willing to pay an 8% cap rate for a property, every dollar of net operating income (NOI) would be worth $12.50 in value. Likewise, if a cap rate is 9% every dollar of NOI would be worth $11.11. As you can see, lower cap rates equate to higher values and higher cap rates equal lower values. <u>Thus it is apparent that cap rates have more to do with the value of the property than the actual day to day operations of the property</u>. In reality, the buyer is actually purchasing the income stream rather than the property. Although I have used a generic illustration here, it is important to note that cap rates are property and market-specific and there is no standardized cap rate that fits every property.

Since Argus has more than 40 Broker Affiliates working around the country and we are currently marketing over 80 self-storage properties, I took a closer look at some recent cap rates at closing and how the properties are being financed.

Cap rates are ranging from 7.75% to 9.25% for stabilized properties with the average falling somewhere around 8.25%. I also looked at the financing terms most buyers are able to achieve today and observed the following; terms of 1 to 10 years, interest rates between 4.5% and 7% and amortization schedules between 20 and 30 years. This puts the spread between interest rates and cap rates somewhere between 100 to 475 basis points, with the majority being greater than 250 basis points.

The chart below shows what impact arbitrage can have on an investment in self-storage when the cap rate is significantly higher than the interest rate. The net result of the arbitrage between cap rates and interest rates is that the greater the spread between interest rates and cap rates, the greater the return an investor will receive on his equity.

Chart I: Rewards of Arbitrage

NOI	$ 200,000	$ 200,000	$ 200,000
Cap Rate	8.25%	8.25%	8.25%
Value	$ 2,424,242	$ 2,424,242	$ 2,424,242
25% Equity	$ 606,000	$ 606,000	$ 606,000
75% Loan Amount	$ 1,818,424	$ 1,818,424	$ 1,818,424
Interest Rate (30 year amort.)	**5.50%**	**6.00%**	**6.50%**
Debt Service	$ 123,876	$ 130,812	$ 137,904
Cash Flow	$ 76,124	$ 69,188	$ 62,096
Cash on Cash Return	**12.50%**	**11.40%**	**10.20%**

Clearly there is value in understanding the benefit of some of the lowest interest rates in the last 40 years. The rewards make the game worth playing and the trick is to make sure the spread between the cap rate and interest rate provides you with a return you can live with. The question to ask is how long will these opportunities last? Your guess is as good as mine but in the game of arbitrage it's all about *Carpe Diem*! MM

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