

Declining Real Estate Values

The Truth Behind The Numbers

— By Aaron Swerdlin

These days, it's tough to turn on CNN or Bloomberg or even the local news and not find yourself bombarded with data about declining real estate values, increasing interest rates, economic pressures, record-high oil prices, or a recession. While it's difficult to not get drawn into the negativity, the key is to absorb the data in the context of what it means to you.



*Aaron Swerdlin
Senior Managing Director
Holliday Fenoglio, Folwer, L.P.*

Certainly, the capital markets are far less aggressive than they were in the first quarter of 2007. The revised, more conservative lending practices have had a significant impact on sales transaction volume. And not just in the self-storage arena, but across all property types.

We as an industry need to be cognizant that sales volume and sales prices are not the only barometer of the strength of our industry. In fact, high sales volume and strong sales prices are largely disconnected from an operations standpoint. When the industry posts strong growth numbers, high occupancy, and healthy rent increases, sales prices benefit. However, as long as there is turmoil in the capital markets, we could post the strongest operational numbers possible but sales prices and sales volume will not represent the full benefit of those strong numbers.

The increase in property values and sales volume during the previous five years has had as much to do with extremely aggressive capital structures and a never-before-seen volume of capital being poured into the industry as it has with the revenue growth numbers that the industry has posted. Quite simply, the laws of supply and demand took over and we had more capital wanting to invest in the industry than owners wanting to sell. So, for the quality assets in quality markets, value increases tracked significantly higher than revenue increases.

Today, we find ourselves in a market that, if taken at face value, appears soft at best. Yes, sales prices have retreated; but operationally our industry is strong. It has long been a popular opinion that the industry is at least recession resistant, if not recession proof. For the last six to nine months we have tested that hypothesis and we proved that we are indeed insulated against recessionary trends.

Velocity drives our business. Whether it is downsizing, geographical relocations, small business fluctuations, or any other event that creates movement, our industry is there to provide the needed service. These needs exist both in economic booms and in times of less economic certainty. The ability to increase rents in the current economic climate is a delicate issue, but maintaining occupancy is not. Compare that to other real estate sectors, and their ability to weather economic disruption pales in comparison.

With all of the chatter about sales prices having declined and with the fewer number of sales transactions announced coupled with the constant commentary about the challenges in the capital markets, it's easy to think that things are worse than they really are. Remember, for the self-storage industry, it is highly likely in 2008 we will again be one of the best performing real estate sectors with positive revenue growth and occupancies that remain stable. We will also see non-distressed property sales at very strong sales prices. Although the volume of transactions will be lower, the quality assets in quality markets will continue to be attractive to institutional capital because our industry remains attractive to the institutional world. Why? Because, fundamentally the self-storage industry offers substantial risk diversification and it is insulated against recessionary trends.