

Question: What are current cap rates?

One of the questions I am often asked is, "What are the current cap rates for self storage?"

While buyers and sellers set the prices at which the buyer will buy and the seller will sell, in today's market looking at the terms for lending will often predict the cap rates at which properties will trade.

Look at a typical lending scenario from a couple years ago. For this example we are assuming the self storage facility has an annual net operating income of \$125,000.

Loan to value (LTV) represents the portion of the purchase price the lender will loan, annual debt service (ADS) is the amount (single payment) that must be paid to the lender for principal and interest, cash on cash is the return to the investor on the cash contributed and cap rate is the capitalization rate that represents the corresponding value (income divided by cap rate x value). With a DCR of 1.2 the facility would have to have cash flow that is 20% greater than the loan amount ($\$125,000/1.2 = \$104,167$).

Amortization	30		Cap Rate	Value	Cash	LTV 80%	ADS	Cash on Cash
DCR	1.2	\$ 104,167	8.00%	\$ 1,562,500	\$ 312,500	\$ 1,250,000	\$ (90,811)	10.94%
Interest Rate	6%		8.50%	\$ 1,470,588	\$ 294,118	\$ 1,176,471	\$ (85,469)	13.44%

As you can see at a debt coverage ratio of 1.2, a 30 year amortization and an interest rate of 6%, a buyer could pay a value equal to an 8% cap rate and still receive a return on the cash invested of over 10%.

But the lenders no longer offer such terms or rates. In today's lending environment one can expect a debt coverage ratio approaching 1.4, a 20 year amortization (possibly 25) and an interest rate of approximately 7.25%. With those parameters notice how an 8% and 8.5% cap rate will not meet the DCR parameter of \$89,285. While the 9% cap rates and above do meet the DCR criterion, the cash on cash return does not attain the same level as in our previous example until the cap rate is 10%.

Amortization	20		Cap Rate	Value	cash	LTV 65%	ADS	Cash on Cash
DCR	1.4	\$ 89,285	8.00%	\$ 1,562,500	\$ 546,875	\$ 1,015,625	\$ (97,739)	4.98%
Interest Rate	7.25%		8.50%	\$ 1,470,588	\$ 514,706	\$ 955,882	\$ (91,989)	6.41%
			9.00%	\$ 1,388,889	\$ 486,111	\$ 902,778	\$ (86,879)	7.84%
			9.50%	\$ 1,315,789	\$ 460,526	\$ 855,263	\$ (82,306)	9.27%
			10.00%	\$ 1,250,000	\$ 437,500	\$ 812,500	\$ (78,191)	10.70%

Given the current lending practices for a buyer to achieve comparable cash on cash returns as was available a couple years ago, the buyer will expect to pay a cap rate of approximately 10%.

As you can see, the market cap rates are influenced greatly by the lending available and while cap rates were in the under 7% to 9% range a couple years ago, currently they are significantly higher as can be seen from this analysis.