SELF STORAGE INVESTING®

“The Complete guide to Finding, Evaluating, Purchasing and Managing Self Storage Facilities”

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Written by Scott Meyers

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SELF STORAGE
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Introduction

The Top 10 Reasons why Self Storage is the Hottest sector in Commercial Real Estate.

As you will read later in the home study course, I began my career by building a large portfolio of single family and multi-family properties. I spent the first 10 years in real estate investment fighting with tenants and toilets and it almost drove me into the insane asylum and the bankruptcy court! Chasing tenants that wouldn't pay, trying to stay ahead of rising taxes, insurance, and utility bills, and the ongoing, unexpected maintenance calls, almost forced me out of the business. So, I began to ask myself, what area of real estate could I invest in that could utilize the talents and experience I have gained, without all the hassles of tenants and toilets? Well, after weighing all options, and after speaking with many of my mentors in the industry, I ultimately chose Self Storage as the area I wanted to pour my efforts into and secure my future.

So, after 13 years of amassing a large portfolio of single family and multi-family apartment complexes, I began to sell them all off, and begin investing in self storage facilities. And as most people say once they have found their true calling, I wish I would have done it sooner! The self storage business isn't without its fair share of challenges however and I certainly wouldn't call it easy. But my life has changed dramatically the day I sold my last apartment complex with all those tenants and toilets and traded them for self storage units filled with nothing but……. STUFF!

This home study course is designed to share my experience with you so that you may find the joy of running your own real estate business without all the hassles that the traditional real estate investment possesses. What you are about to read is **the most comprehensive system to create wealth In self storage available anywhere on the planet!** Whether you are new to the industry, or an experienced real estate investor, I encourage you to read, and continue to reference this course throughout your Self Storage real estate investment career.

Now, I will share with you the top 10 reasons why I decided to sell all my houses and apartments to invest in self storage:

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10. **Endless Opportunities** – If you already own a plot of land in a GOOD location, you can build. Now I don't want to oversimplify the process because there are a great deal of zoning and Approval hurdles you may have to jump over, but this is a real estate business that is much easier to get into compared to most others. Also, contrary to popular belief, the large, public operators in the industry only account for about 25% of the estimated 24 million units in this country worth $22 Billion in 2012. Many of these are "mom and pop" facilities that are already established and cash flowing, and were developed specifically to sell off to investors once they were stabilized!

9. **Demand Projections are on the rise** – Demand for storage has been on the rise, with over 23,000 facilities having been added since 2000. But probably the most exciting prospect for the industry is the aging of the baby boomers. There are roughly 77 million baby boomers in this country as of 2012, and they account for approximately $2 trillion in spending power. A recent poll by the Self Storage Association of a sampling of Baby Boomers revealed that upon retirement, **50% planned to travel**, **40% planned to move**, and 10% planned to start a new job. What do people do when they move? That's right, they store stuff. Downsizing, buying a second home, or even a like swap in houses necessitates a need for storage. **One economist recently compared the opportunity in this industry to sitting on the oil industry in the 1950's or sitting on Silicon Valley in the 1990's!**

8. **Multiple ways to increase Value** – I have had a great deal of success in creating value with properties once I acquired them, but found the opportunities greater with self storage. There's only so much you can do to a house, or with apartments that truly adds value, or commands a higher rent. But with Self Storage, you can take a vanilla facility and create multiple additional income streams such as:

   a. **Retail centers that sell locks, boxes, moving supplies**
   b. **A Truck Rental service through a 3rd party, or in-house**
   c. **A business center that charges for computer usage, copies, and fax**
   d. **eBay® Add-it centers is where customers can pay you to sell their "stuff"**
   e. **A pack and ship business**

These additional services can contribute as much as 5-7% of the total income a facility brings in on a monthly basis.

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7. **More Predictable Variable Costs** – With my apartments, I was responsible for paying the utility costs for many of the common areas and vacant units, and in some properties, the gas and water was on 1 meter, and was included in the rent. I was forced to pay for my tenants' wasteful use of gas and water. When the cost and/or taxes on these utilities increased, guess who paid for it; ME! You simply can't pass those increases along to the tenants without them going down the street to a competing property. With Self Storage, however, the expenses are minimal to begin with. You will pay for lights in the parking lot, and utilities for the office, but those can be monitored, and increases can be easily absorbed. **This makes budgeting for utilities and other variable costs a breeze compared to properties with tenants and toilets.** As a result, self storage operating costs are typically much less than office, retail, and apartment buildings, which lowers the overall break-even occupancy.

6. **Minimal Collection Losses** – 47 of the 50 states have a lien law with regard to self storage collections procedures, and the other 3 provide for steps that an owner can take to collect past due rent. Each state's law differs slightly, but most give the self storage facility owner the ability to perform the following steps when a tenant's rent is past due:

    a. **Remove the tenant's gate code from the system, locking them out of both the facility and their unit.**
    b. **Place another lock on the unit to keep them from entering it. This is what we call over locking the unit.**
    c. **Auction their goods if payment has not been received, typically within 90 days after they were given notice.**

Each state requires that the tenant be given notice that they are past due, and most require proof that notices were sent by certified mail or some other traceable format. Each state also specifies specific timing for each one of these actions, and also requires that proper notice is given to the tenant, and to the public by way of the local newspaper that their unit is being auctioned off. The laws also specify what an owner can and can't do with regard to the tenant's belongs, and most require that the entire unit is auctioned off as a whole to avoid any liability. Either way, this far better than a landlord's recourse when going through the legal process of evicting and collecting back rent from tenants in the single family and multi-family apartment world.

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5. **Excellent Cash Flow –** Rental rates for self storage facilities are similar to other real estate product types; however, lower development and operating costs create higher profits and a greater return for investors. In addition, leases are month to month, which provides the ability to raise rents in conjunction with market demand. Self storage tenants won't typically rent a truck, call their friends, and waste a Saturday morning to move their stuff down the street just because their rent increased by $3 per month. But if you raise rents once or twice a year by 3-5%, multiplied by several hundred units, with no increase in expenses, you begin to see why **industry experts so often refer to self storage facilities as the proverbial "Cash Cows".**

   By contrast, if you were to raise your rents in your single family or apartment portfolio by 3-5% once or twice per year, you would have a mass exodus on your hands!

4. **Low Risk** – Self storage space is rented on a month-to-month basis to hundreds of different customers, most of which are individuals and small businesses. With self storage, no single move-out is going to cause a major drop in rental income. Compare this with other forms of commercial real estate, where a Flagship tenant or multiple high paying tenants can really spell disaster. In addition, self storage has the ability to absorb economic fluctuations better than other real estate investments. For example, when the economy is good, people buy more therefore they need extra space to store their extra stuff. And when the economy is down, individuals and businesses may downsize their house or business space, and therefore turn to self storage as a cost-effective place to store their belongings.

   As a result, self storage has the lowest failure rate and subsequently lowest loan default rate of any real estate product type.

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3. **Leverage or Other People's Money (OPM) –** Given the fact that self storage has the lowest loan default rate of any real estate product type, lenders are now making 80% - 90% LTV loans on established, well-constructed, and well managed facilities with strong track records.

   In addition, there are several private investors that are funneling millions of dollars into the market to partner with self storage developers and investors due to the industry's tendency to outperform the stock market and other real estate investments. And given the reasons I just discussed, and the industry's track record, it is much easier to convince your wealthy friends and family members to become investment partners in a self storage facility than it is with other real estate product types.

2. **No Tenants –** The number of times you will be in contact with the typical Self Storage Customer is very minimal over the duration of their tenancy. According to the Self Storage Association, 95% of self storage customers do not return to their unit until the day they move out of the facility. Therefore, the industry norm for hiring a manager is based on a 1 to 400 ratio, or 1 manager to manage every 400 units. There are also several owners who are taking advantage of new technologies that have become available in the self storage industry, most notably, kiosks. These machines resemble an ATM and are typically installed at the front gate and allows a customer to rent a unit, pay with a credit card, and even dispense a lock, all without ever coming in contact with the manager! In contrast, the widely accepted rule of thumb for managing single family and multifamily properties is a 1 to 100 ratio, or 1 manager for every 100 units. Quite simply, single family and multi-family tenant commands a greater amount of babysitting. You have to chase them for rent, answer their maintenance calls, respond to complaints about dogs, kids, their neighbors, broken down cars, noise, bugs, etc., and spend an incredible amount of time writing letters and responding to each one of these issues or for every time someone is in violation of their lease, or the house rules. In addition, the eviction and collection cost each month is very time consuming, with little results. By comparison, I have never taken a phone call from the patio furniture in unit 105 complaining that the lawnmowers in unit 106 were playing their music too loud!

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1. **No Toilets –** The typical self storage facility is constructed from steel, or concrete, has a steel roof, metal doors, gravel or asphalt drives, and most likely, a stainless-steel fence. Some may have a small office on site with a computer, phone, and **1** bathroom; that's it! Steel walls and roofs last for decades without any maintenance. Door springs need to be replaced from time to time, and every 10 years or so you may have to add more gravel, or resurface the lot, but can be easily budgeted for, and most fences last 20-25 years without the need for any maintenance. And of course, the enemy of all landlords, toilets, or any other indoor plumbing for that matter, is non-existent in a self storage facility. And unless you have climate-controlled units, there are no furnaces, air-conditioners, or water heaters to maintain. **When a tenant moves out, you don't have to clean, paint, or replace the carpet; simply take a broom or blower, and sweep it out!**

There are many other reasons I prefer self storage to other real estate product types as we'll discuss throughout this home study course. I have thoroughly enjoyed the business, and I am thankful for the opportunity to pass this knowledge on to others that may be interested in the industry. In addition, I consider myself a lifelong student in the business, and I believe in perpetual improvement.

I encourage you to contact me to share your thoughts on the home study course, and ultimately, share your testimonials of facilities you have successfully acquired.

I can be contacted by email at Scott@SelfStorageInvesting.com or by mail at:

Self Storage Profits, Inc.
Attention: Scott Meyers

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About the Author

Scott Meyers has been the president of Alcatraz Storage™ and its affiliated companies since 1993. His current full-time responsibilities for all companies include the supervision of all aspects of acquisitions, management & operations, construction, financial oversight, and daily strategy meetings with staffers.

Scott began his real estate career by purchasing, rehabbing, and selling a single-family house with no money out of his own pocket. He took that knowledge and built on it to eventually buy, rehab, and sell over 75 single family homes in the Indianapolis area valued at over $6,000,000.

He quickly graduated into the into the commercial real estate arena by purchasing, rehabbing, and selling over 200 Apartment units in 4 separate developments valued at over $7,000,000.

In addition, Scott was previously the Owner and Executive Director of Indiana's largest Private, Small Business Incubator; a 200,000 s.f. facility with over 100 tenant-clients, designed to assist small companies in the start-up phase.

Scott currently owns and manages over 1200 self storage units in multiple facilities throughout the Midwest and plans to continue to grow his current portfolio to 1,000,000 Net Rentable Square Feet by 2012.

Scott is the Founder and current President of the Self Storage Association of Indiana, the statewide chapter of the National Self Storage Association (SSA) and received his Certified Self Storage Management Designation (CSSM) through the National Self Storage Association in September of 2007. He has also taken several executive level courses and attends numerous seminars and tradeshows sponsored by the Self Storage Association on an annual basis.

Scott was also selected by The Indianapolis Business Journal for its annual 40 under 40 list of up and coming Indiana business owners in 2007 for his accomplishments in mentoring small businesses through his small business incubator, and the many successes he has enjoyed in his own business, Alcatraz Storage™

Scott was the past President of the Central Indiana Real Estate Investors Association (CIREIA) from 2003-2004 in which he doubled the group's membership over 2 years from roughly 300 members to approximately 600. In addition, CIREIA won 2 awards of excellence in successive years from The National Real Estate Investors Association as

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being the best run group in the country under Scott's direction. Scott was also the cofounder of the Indiana Real Estate Investors Association (IREIA) in 2005 and served as the annual conference chairperson for 2005 and 2006.

In April of 2006, Scott was invited to serve on the Indianapolis Economic Development Advisory board which acts as an advocate for economic development programs and projects in Indianapolis and the surrounding communities.

Scott also spent several years as an instructor of the Landlord 101 course through the University of Indianapolis in partnership with The Central Indiana Real Estate Investors Association teaching investors the best business practices in managing rental real estate.

Scott received his Certified Apartment Manager (CAM) through the National Apartment Association in 2004 and was a member from 2001-2006.

Scott has also been a member of the Indiana Chapter of the Young Entrepreneur's organization (YEO) since 2000.

Scott has held an Indiana real estate license since 1998 and has brokered hundreds of deals worth over $12 million dollars.

Scott is also a Crown Financial Ministries instructor and Budget Counselor, and directs the financial ministries at the church he and his family attend.

Scott attended the University of Michigan and worked 8 years in the telecommunications and software industries before starting he founded his own real estate companies.

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CHAPTER 1

Industry Overview

Scott Meyers

Self Storage Association Definition: *Self Storage facilities are real property designed and used for the purpose of renting or leasing individual storage spaces to tenants who are to have access to such space for the purpose of storing and removing personal property. They offer rental on a month-to-month basis of individual spaces where customers provide their own lock and have sole access to their space.* Today's typical storage facility may comprise several one or two-story buildings on two to 6 acres of land, or a multiple-story building, containing a carefully designed unit mix of spaces. The units typically range in size from 5X5 to 10X30 feet with 30,000 to 120,000 total rentable square feet of space. Self storage facilities frequently feature large roll-up doors and drive up access to outside spaces and offer outside parking for storage of boats and recreational vehicles, which often can't be stored in residential communities.
Today's facilities normally have the following features:

- Contain 10,000 to over 100,000 rentable sq. ft.
- Offer a wide range of unit sizes
- Are well lighted
- Are paved vs. graveled
- Have storage units divided by steel, movable panels
- May have some or all of their space's climate controlled
- Contain high-tech security systems, including electronic access, cameras, and digital video recording.
- Have perimeters that are walled or fenced with Security Gates
- May or may not have a resident manager
- Have single or multi-story buildings
- Provide carts and Dollies for use by its customers
- May contain movable storage modules
- Sell storage and moving related supplies
- Provide ancillary retail services and products.

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From the real estate perspective, self storage:

- Meets the needs of several consumer groups (residential & commercial)
- Uses simplified structures
- Makes efficient use of land, especially odd shaped parcels in less desirable locations
- Has short construction time, thereby providing little traffic disruption
- Uses very little energy!

HISTORY

The conventional concept of personal storage began in England when British banks were asked to safeguard valuables for clients embarking on extended voyages. Overcrowded vaults quickly forced them to seek storage lofts from drayage companies (the first moving companies). The first mini-warehouses for household and personal items were built. The two-story structures were built with packing on the lower floor and private storage rooms on the second. Except for expansion into multi-story buildings, things remained the same for decades, until the 1950's when costs rose. This led to construction of palletized warehouses which were designed to handle crated customer goods that could be stacked three levels high.

Access to household/personal goods was restricted and it was expensive, since customers had to make appointments to obtain items and pay each time for the service (stored property could only be reached by forklifts which were operated by staff) and business hours were limited and normally did not include weekends.

Initial development of self storage facilities in the US occurred primarily in the Western United States and the Sunbelt states. Contributing factors were: a transient population moving to new jobs and better climate, retirement condominiums, apartment and townhouse residences, slab construction, etc.

Many facilities were developed prior to 1979, with 1978 generally acknowledged as one of the greatest growth years in the industry. As the decade of the 1980's began, increased self storage construction activity occurred along the Eastern coast of the United States, with increased interest in Canada, Europe, Australia and other countries of the free world.

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SELF STORAGE TENANTS

It's been said that self storage is used by people and businesses in transition, but that's only part of the picture. Self storage is used by a wide range of consumers with different needs that may include:

- Homeowners and businesses in need of temporary space for overflow of property or inventory
- Those in the process of relocating
- Property stored in relation to an estate in transition due to death, litigation, restoration, etc.
- Businesses in need of space for general control of inventory, records, supplies and equipment
- Businesses that are expanding or contracting
- Businesses storing seasonal displays
- College students storing books, desks, etc. during summer
- Military personnel in need of low-cost space or are on temporary duty
- Seasonal visitors with household items and sports equipment

The advantage of using rental storage space is increased flexibility, low cost, convenience, and value.

Self storage space is generally rented on a month-to-month basis and does not commit customers to long term leases. Tenants may typically leave whenever they want and rent only the space they need. A recent study shows that the average length of tenancy for a typical customer is 11 months, and 24 months for the average commercial tenant. The cost of self storage space is lower than office or retail space, saving users money. On average, self storage is roughly 60% less than the cost of most office on a per square foot basis. Self storage users can often find facilities in their local area and they receive additional service value because self storage managers are trained to counsel consumers on how to store items more efficiently in less space, thereby reducing the cost.

Self storage is a useful management resource for small businesses, since businesses can easily obtain more space as they grow without committing to expensive long-term leases. Furthermore, it provides businesses with a means to cut costs, should they need to downsize. Self storage is also useful for college students and seasonal visitors who may rent space for a season, and for military personnel who go on temporary tours of duty, but intend to return to the area, and for those who can't afford to rent more living space.

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TODAY'S MARKET

Estimates of the overall number of self storage facilities operating in the United States varies greatly but most industry veterans estimate that there are somewhere between 45,000 and 50,000 facilities as of the date this home study course went to press. As the population becomes more familiar with self storage, the demand for offsite storage has expanded to accommodate the growing needs of the business community by storing files, medical records, excess inventory, equipment, etc. In some areas business storage accounts for 30% or more of the total tenancy of a facility. Easy access, convenient office hours, short term rental agreements, and no long-term commitment to pay for space which may not be needed in the future, make the self storage facility extremely attractive to the retail customer, contractor, home based businesses, manufacturer's, and pharmaceutical representatives, etc. The industry still remains relatively unsophisticated and highly fragmented.

Today, roughly 75-80% of all self-storage facilities are owned by small independent "mom and pop" operators.

In addition, there is a considerable amount of medium to large players undergoing consolidation, although it is becoming more difficult for the larger buyers to accomplish since most owners realize what a great low maintenance high-cash business it is, and therefore are reluctant to sell. As a result, the top 50 companies control approximately 25 percent of the square footage in the industry.

As demand for space has grown and the self storage industry has evolved, consumers have become more familiar with the property type (92% of the households in the U.S. were familiar with the concept, according to a survey sponsored by the Self Storage Association in 1989). Inasmuch, local and regional competition ranges from a handful of properties to scores in a given trade area. Accordingly, customers may choose where they will store and from many different options, with unit size and the choice of climate or non-climate controlled space being the base options. Today consumers have the ability to compare and choose from among a variety of self storage property styles and customer services to meet specific storage needs.

Competition in the self storage market is increasing. Maximum success for investors/operators depends on the ability to meet customer needs with convenience and value.

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To satisfy customers, today's self storage must look to locate in retail corridors, light commercial or even high-density residential neighborhoods, in addition to traditional industrial and heavy commercial areas. Newer facilities emphasize architectural aesthetics in construction and are designed to blend in with the retail or residential nature of the areas they serve. Landscaping has also become a prime consideration, as well as the interaction of storage development with adjacent planned tracts of offices, retail stores and business parks, in order that incubator space is available to support public planning. All of this is done with the aim of creating a clean, stable, secure upscale image that supports the perception, and the reality of trust among current and prospective customers.

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CHAPTER 2

Investment Opportunities In self storage

Scott Meyers

Like all other real estate investments, self storage shares the same attractive qualities as residential rentals, apartments, retail strip centers, office buildings, and industrial properties. **Those include leverage (borrowed money), tax advantages, passive income, personal control (being your own boss), and appreciation.**

However, self storage offers a number of benefits that I feel make it such an attractive investment. Those include the following:

1. We are becoming a more transient society, moving around more and creating a greater need to store our stuff, thus the demand for self storage is increasing.
2. Americans tend to accumulate a great deal of possessions, and we don't want to "weed out" those things we don't use or are sentimental or have nostalgic value, which in turn, creates more demand.
3. Most new communities will not allow us to store our boats, jet skis, RV's, or even multiple cars on the street or in front of our homes.
4. Many retirees downsize their homes which require additional storage space that their smaller homes don't provide.
5. More and more Americans are buying second homes which increase the demand for storage space.
6. College students utilize storage space when moving back home for the summer.
7. Many businesses are downsizing and operating out of smaller offices that necessitate a need for storage space.
8. Many small distributors will utilize self storage to operate their business from.

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9. Pharmaceutical reps will use climate-controlled storage for samples and inventory.
10. The eBay® phenomenon has created a huge demand for space.
11. Other home-based businesses are also creating demand for off-site storage.
12. Lower Development costs – self-storage facilities development costs are often 30 to 50 percent less than office, retail, and apartment buildings.
13. Lower Operating Costs – Operating costs for self-storage facilities are substantially less than office, retail, and apartment buildings. As a result, self storage owners are more isolated from large increases in utility and other variable costs that occur in the open market.
14. Lower development and operating costs make break-even occupancy ranges lower than other forms of real estate.
15. Occupancy is generally more stable and therefore predictable as there are typically a greater number of units in which to "spread the risk" than in other forms of real estate.
16. Month-to-month leases mean that rental rates can be adjusted easily. When occupancy increases, I will adjust rates to compensate for the demand.
17. Demand for self-storage is not dependent upon the economy. When the economy is good, people buy more and store more. When the economy slows, people downsize, and require a cheaper alternative to store their extra belongings.
18. Low management overhead as customers typically only need the manager to move in or move out, compared to office or apartment complexes that requires a high number of customer contacts and constant and ongoing interaction.
19. A well-run, stabilized self storage in a good location is very desirable to other investors and institutions, making self storage a very liquid investment.
20. **It's No Wonder Self Storage has the lowest loan default rate of all commercial real estate property types!**

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DEBUNKING THE MYTHS

Now that we've discussed all the reasons that make self storage a fantastic investment, we should take some time to break down a few of the myths that have been floating around with regard to the industry. Like many other industries, self storage has been evolving for several decades now, and many of the general assumptions by outsiders surrounding this business simply do not apply. Some of the common myths are as follows:

1. "If you build it, they will come".

In the early years, this was somewhat true. But in today's competitive landscape an owner/investor must perform very careful analysis and/or feasibility studies to determine whether a potential development site or an existing facility is a wise investment. In addition, there are many areas that are, or are becoming overbuilt, which drastically changes the projected lease up and overall occupancy potential for a facility.

2. "Self-storage is an easy business".

This may have been somewhat true in the past as well, but like any business, if it were easy, everybody would be doing it. Far too many real estate investors treat their business as a hobby rather than what it truly is; an asset with many moving parts that must be managed from day to day as opposed to a stock or a mutual fund that you purchase and only infrequently check on its performance. Today's self-storage arena is very competitive, and successful owners are always thinking of ways to increase income, decrease expenses, and strive for operational efficiencies across all facets of their operation.

3. "All self storage properties are cash cows"

As we discussed earlier, self storage facilities have the lowest default rate of all property types, but it doesn't mean that owners don't default and that many others are struggling. Generally, this is due to poor planning before acquiring or developing a facility. An owner/investor must perform thorough due diligence when it comes to competition, population growth, land costs, construction costs, market rental rates, and the management of the facility **before** purchasing or developing a facility. If you do not have the time nor the expertise, a feasibility study should be conducted by an experienced individual within the industry to avoid buyers or developer's remorse.

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4. “This is a cheap business to get into”

Again, this may have been somewhat true in the past, but not any longer. Today’s customer is demanding a higher quality facility than what the industry provided in the beginning. Today’s facilities possess a higher quality construction, are fully paved, fully fenced with security gates, typically have state of the art digital video surveillance and recording systems, and are considerably larger than in the past, which necessitates an office with a part-time or full-time manager. Land costs are higher as most developers prefer to locate in high traffic locations as opposed to the hard to find or industrial park sites of yesteryear. In addition, construction materials have been on the rise recently due to fast developing foreign nations which affect development costs, and good existing facilities are being sold at record high prices as the word is out on what a great investment self storage has become.

Self Storage Profits, INC.

Self Storage Acquisitions

The step by step system for creating wealth in self storage

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CHAPTER 3

The Future of Self Storage

Scott Meyers

As we look to the future of self storage, it's very clear that the future looks bright. There are a few trends afoot backed by solid industry data that justify my positive outlook on this high growth industry. These trends are as follows:

Increasing Demand

The U.S. Population is predicted to reach 400 million by the year 2050. All indicators show that Americans continue to be a highly mobile society with a high propensity to accumulate "stuff". This means that as of the time of this publication, we stand to add 150 million potential customers to our prospect list who are searching for somewhere to store their belongings.

High Tech Facilities

As our customers become more selective in where to store their belongings, owners of older facilities will need to make necessary improvements to remain competitive. This will ultimately result in more sophisticated and higher tech facilities offering more user-friendly layouts, larger offices, flexible unit mixes, kiosks, high security, and more climate control units. In addition, we can expect to see self storage investors competing for the premier parcels located in the high traffic retail areas of town. As a result, municipalities are beginning to require that these facilities have a retail component in order to increase the amount of sales tax generated and paid to those local governments. They are also requiring that the facilities have a certain "look and feel" that blend in with the surrounding businesses. Nicer fencing, or split block security walls, paved drives, certain architectural features, and an attractive landscape package will be mandatory and made part of the architectural permit prior to construction, and strictly monitored for compliance.

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More Products and Services

As self storage moves closer to Main Street, we will begin to see an increase in the number of customized services available for its customers. We have already seen some partnerships being formed that provide complementary products and services. Of course, the most common example is truck rental, but we are now seeing pack and ship businesses, EBAY® add-it stores, Kinko's®, or co-locating with retail stores such as Starbucks® or Subway® on the ground floor with storage above in multi-story facilities.

Focus on Customer Service

As more and more people frequent our self storage facilities, they will begin to expect more from our facilities and the face behind the counter. These sophisticated customers are demanding excellence and consumer loyalty will quickly go out the door, along with their stuff, if they have a bad experience. Conversely, when customers are satisfied with the service they receive, they will stay, and hopefully will tell their friends about the good experience they have had. This provides an excellent opportunity for us to exceed their expectations, and provide a substantially better experience than our less educated, less professional competitors in our chosen markets. **My goal is to be my customer's LAST storage provider by never giving them a reason to look anywhere else, for any reason!**

Industry Consolidation

As the larger public companies and REIT's are pressured by Wall Street to produce results, we will surely see more consolidation of the mid to large size companies. Those same mid to large companies can't meet their growth deadlines by developing their own facilities from the ground up. The 3 years it takes to choose a plot of land, apply for zoning, permits, and then build and stabilize a property simply isn't fast enough for them to meet their goals. Don't misunderstand me however, the mid to large companies ARE still active developers, but their appetite for growth will fuel a surge in acquisitions and mergers for years to come.

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Increased Competition

As all eyes are now on Self Storage, we are sure to see a number of new entrants into this facet of commercial real estate. Unfortunately, this will lead to overbuilding in some areas as many newer developers will ignore the feasibility criteria for developing a facility in a given market. Therefore, it will be imperative for owners and developers to work more efficiently to attract and retain customers in this new environment.

Increase in Value

In the future, the upward value trend in self storage will continue for a number of reasons:

1. Predictably low interest rates will push cap rates low, and net larger profits for those who choose to sell.
2. For that reason, self storage continues to rise in popularity as one of the commercial real estate assets of choice, and will ultimately attract more investors.
3. There are still a number of individuals and investment firms that are stinging from the recent stock market corrections. These investors are now searching for a more stable investment that they can "touch and feel" as opposed to investing in a company that they have never heard of, run by people they have never met, in an industry they know nothing about.
4. There is a lot of money chasing a few deals. Many investors have created a great deal of value in their existing portfolios, and they are selling off these properties and are looking for places to spend their 1031 tax deferred exchange dollars without paying taxes. Self storage has continued to be a great investment to exchange into and more and more investors are choosing to park their dollars here before their tax deferred status expires.

As the saying goes, the only thing we know for sure is that things are going to change. I do subscribe to that line of thinking, but I also believe that self storage will remain a reasonably predictable, stable, low maintenance, high cash flow investment for professional investors for years to come.

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CHAPTER 4

To Buy or to Build

Scott Meyers

The Advantages of Buying versus Building

There are several advantages to buying rather than building a self-storage facility. These advantages include:

1. **Quick Entry**

Quite simply, buying an existing facility will get you into the business faster. Bypassing the development process will allow you to take over an existing operation without the time and hassle of building and creating the business from scratch.

2. **Predictability**

Buying an existing self-storage facility gives you a historical track record based on past operational performance. This will provide indicator to the future success of the facility all things considered.

3. **Ease of Financing**

Typically, financing an existing facility with a proven history of net operating income is much easier than construction financing which is highly speculative. There is a wide variety of products available to finance existing facilities in today's market. Financial institutions have a large appetite for well performing self-storage facilities and therefore are offering high loan to value loans at very desirable interest rates.

The advantages of Developing versus Buying include:

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1. Not buying someone else's problems

When buying an existing facility, you may be buying someone else's problems that can prove expensive to fix. Be certain to have a licensed inspector perform a physical inspection of any facility you may be interested in purchasing, and be sure to verify all income and expense reports to determine the true Net Operating Income of the property to avoid any surprises.

2. Choice Site Selection

Developers are free to choose a location far from competitors and be first in an area that is experiencing a high rate of development. As in most businesses, if you are first to market, you can grab onto the customers in that area, and in self-storage, customers typically don't move their stuff just because another competitor comes to town.

3. Low start-up Cost

The cost to buy land and develop a facility is usually significantly lower than the price of acquiring an existing facility, looking strictly at a cost per square foot basis.

4. Preferred Product

A developer can build a state-of-the-art facility to meet market demand. It is much easier and more cost effective to build a facility with all the new industry "bells and whistles" than it is to retro-fit an older, tired facility with electronic gates, paved driveways, digital video surveillance systems, newer door/locking systems, business centers, kiosks, or adding a retail center and office.

5. Potential for Higher profits

If you do your homework and choose a good site, and build a marketable facility from both a user and a potential buyer's perspective, you could reap a windfall of profits upon stabilization and ultimately the sale of your facility. Of course, there are no guarantees, but history has shown that developing, and managing a facility to stabilization and then selling has proven to be considerably more profitable than buying and selling an existing facility.

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CHAPTER 5

How I work

Scott Meyers

One of the more common Requests from our mentoring students and clients who have spent a “coaching day with Scott” here in Indianapolis – tell and show me how you work Scott. So, this Chapter is dedicated to the Exact things I do on a typical day in the life of a Self Storage Investor. It’s actually pretty boring, and you could skip this chapter altogether without having missed any “golden Nuggets” of the Storage Business. Feel free to move on to the next Chapter

“Here’s your Chance to Skip this Chapter on the Boring Details of What I do on a Day to Day Basis”! There, you’ve been warned – you can’t blame me if you found it was a waste of time.

4:30 am – My Opportunity Clock Awakens me.

To Quote Zig Ziglar, “Our terminology is all wrong” Alarms scare people – I now refer to it as an opportunity clock. I rarely hit snooze because I’m pretty excited about life in general and I don’t want to waste anymore time sleeping. 5-6 hours is enough for me. As soon as my feet Hit the floor, I say a 3 second prayer, thanking God for another Day. Then I put on my workout clothes and head down for the 1st cup of coffee.

Daily Vitamins, and Drugs

While the water is boiling, I take my Liquid Multivitamins, and a few others including Calcium, Vitamin B, Tribulus Terrestris, Fish Oil, Gingko, Vitamin E, Magnesium, and my prescription Adderrall. Yes, like many entrepreneurs, I was diagnosed with ADHD at 6 years old. I struggled with it all my life, avoiding medication, until a good friend of mine (who also struggled with ADHD) began taking Adderrall. He told me how it literally changed his life. So long story short, at 41, I finally decided to try it – and yes, it’s like

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someone flipped a switch in my brain. I can now FOCUS on my wife, kids, completing tasks, and actually remember what happens in a movie I watched after a week. If you think you might have the symptoms, talk to your doctor.

All Right, this isn't a chapter on Drugs, and I don't get paid by the makers of them. So next I finish making my coffee.

Coffee

Now I could literally write a small book just on coffee – I'm a coffee and wine snob – and I admit it. For my first cup at 4:40 am, I use a coffee press because it's quiet and won't wake the family. I also grind my coffee the night before so as not to wake them, but it's not the same as ground the minute before you brew. After spending a few weeks Costa Rica with the family, the region that arguably produces some of the best coffee on the planet, I became hooked. I especially like the Costa Rican Terrazu, a region that grows coffee on the site of a dormant volcano. We toured the coffee plantation and got a great education into this little bean that I've come to love and consume several times per day. I also enjoy Kenya AA and a few others, but nothing beats the Costa Rican Terrazu – in my opinion.

So, I pour the water in the coffee press with the fresh Terrazu to steep a few minutes and then into the mug it goes with just a little Cream and I'm off to the gym.

The Gym

I belong to La Fitness – 1 – Because they have a nice, big, new facility just 3 minutes from my house, and 2 – because they're all over, and I can always find 1 when I travel.

I arrive at 5, and leave at 6:30. Here's the typical Routine:

Monday – Legs, Abs, Cardio
Tuesday – Back, Abs, Cardio
Wednesday – Biceps, Abs, Cardio
Thursday – Shoulders, Triceps, Abs, Cardio
Friday – Chest, Abs, Cardio
Saturday & Sunday – Either a long walk, or Long Ride on the road Bike

I usually ride the stationary bike at the gym so I can read something spiritual or thought inspiring.

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Then, I head home to shower up and Eat Breakfast with the family.

Breakfast

I'm a creature of habit, and I really stick to a pretty strict routine. That includes a pretty boring diet, with the exception of Dinner. Breakfast is almost always a Protein shake and 6 scrambled eggs, with only 1 or 2 egg yolks – just about every day for the past 15 or so years! I usually make breakfast for the kids while Christina makes the lunches on the days the kids go to school. Our kids are homeschooled so they go to school 2-3 days per week and then Christina makes sure their work is done and handles the lessons the rest of the week (that's how we travel to Costa Rica for 3 weeks at a time). Then I make my 2nd cup of coffee. For this one, I get to Grind it fresh, and use my Espresso machine to concentrate it and get all the oils into the cup – you know, that brown film on top that looks like cream. I have a Breville Café Venezia Espresso Machine that I bought on Amazon: www.amazon.

This cup is much better, and I can steam my cream with a little bit of Carnation Coconut Cream Flavor as well. Heavenly.

Office Tools – Computer, Phone, Software

Once our computer repairman was staying for dinner, I realized it was time to make a change. Countless viruses, crashes, lost data, and low battery life was keeping me from being as productive as I could be, so I decided to buy a Mac. And like everyone else, I don't know why I didn't do this sooner! I am on my 2nd MacBook Pro now, and don't plan to go back to PC's anytime soon. I run the Mac version of Windows on it, and I can't say there has been a time when having a Mac has kept me from running any software I want. Especially since everything is web based now, and all I need to do is connect to the internet. And the Mac does it at lightning speed, and with unbelievable reliability, and long battery life. It's all solid state – no moving parts – they're unbelievable, and the retina display is killer. Do yourself a favor, if you're struggling with the price, just look at how much time you have lost fighting with your PC, and then multiply that by your hourly rate and you'll quickly see that it just makes sense to switch. Besides, over 80% of all college students use a Mac – it's just the way the world is headed – their operating system is far superior, and is being used on multiple platforms in all types of consumer electronics products. You don't have to break the bank either – buy one refurbished for the same price as your clunky PC. I also use a second monitor both at home and in my office, and many times, I'll take another one with me if I am going to be traveling for long periods. Again, get a bigger one with high resolution, you'll thank me later. This has dramatically

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increased my productivity, and I'm thinking about using 3 pretty soon – Think about it, how many apps or programs are you working on at any given time?

I also have a Fujitsu ScanSnap portable scanner (kind of big, but still portable) to scan just about EVERYTHING, in an effort to go paperless someday. It's a breeze for emailing docs or items I want to store on my mac or in Evernote (see below). I purchased a Blue Yeti Microphone to "up my game" when it comes to recordings and for podcasts.

Phone – Ditto. IOS rules. The iPhone has more available apps and access to data such as podcasts, quicker access to all functions and connectivity than Android or any other operating system – Period. No-brainer here as well. And while you're at it, ditch your home phone – what's the point? We're the only country in the world that still uses a home phone to the degree we have become accustomed to. Cut the line, and cut the extra expense.

Software – I spend the bulk of my time working through my Google Calendar with all my tasks and projects being managed by teamworkpm https://www.teamworkpm.com. I also use Evernote.com for storing important articles, and other information I want to archive for future use. I frequently use Skype.com and gotowebinar.com for web meetings and webinars, and for those I need to record, I use screenflow.com. Many of the quick tasks that either I or my team don't have the time for, we farm out to Fancyhands.com or Fiverr.com for our VA's to handle. And of course, I have Microsoft outlook loaded on my Mac for PowerPoint, Word, and Excel, which I use quite a bit.

Day in the Life

My day starts at approximately 4:10 am. I'll have a cup of coffee and walk down the block before heading to the gym when it opens at 5:00 am. I mostly lift weights and then ride my bike in the summer, or the stationary bike in the winter. Then I'll clean up and read my Bible or listen to a faith-based podcast before landing at my desk around 7:30. I begin the day by prioritizing my calendar and tackle the most difficult but most important items first. I only check emails at 11 am and 4 pm to ensure that I am in control of my schedule, rather than being a slave to other people's agenda for me. I will then check in with my team and delegate as many tasks as possible. I try to split my days by only working on investing certain days of the week, and only focusing on our Education Business the others. It's not always easy, but it puts me in a good frame of mind when I do so. The Morning is reserved for the harder, more creative and cerebral work. The afternoons are for returning calls, emails, and scheduling appointments. As I mentioned previously, the tools I use are my google Calendar, Evernote, Teamwork pm, Gmail, Fancy hands, and

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of course PowerPoint, Excel, and Word. I run a pretty simple business quite frankly, with a few apps and hacks that make doing business a bit more efficient.

Work/Life Balance

I joined Dan Sullivan's Strategic Coach program several years ago, and learned the meaning of and how to be purposeful with my time, rather than let my schedule dictate my work and personal life. If you let it, your business or job could consume every waking hour. I decided to take a step back and look at my business as a means to having the cash flow and freedom to do what I wanted to do, rather than allow it to become an all-consuming, time sucking, energy zapping, 24 hour/day monster that needed to be fed. I started by setting some boundaries and scheduling free time. Because if you don't schedule free time and or time with family, yourself, and your friends, well, it just won't happen. Because waiting for that "free time" when you are all caught up is an illusion that so many entrepreneur's accept as truth. Most days, I'll work from 7:30 am to 5:00 pm with no lunch break. Then I have a hard stop at 5:00 to help my wife with dinner and catch up on her day. Dinner time is a priority in the Meyers household, and you'd better have a darn good reason why you're not at the dinner table with the rest of the family. We also go so far as to avoid extracurricular activities that interfere with family dinner – yes, we're that adamant. If there are activities, we try to travel and attend them as a family, rather than one parent going off with one or more of the kids for the balance of the evening. After the kids go to bed, my wife and I will spend time catching up on calendars, talking, planning, and just relaxing. There are nights when some work or preparation for the next day must be done, but again, here comes that word, we are intentional about spending time with one another. Saturdays, I will still get up early, exercise, and catch up on some emails or other projects for a few Hours, and will usually shut down once the kids get up, and the rest of the day and Sunday are spent with the family and to relax and clear my head. I probably work around 50 hours per week on average – some weeks more, most weeks less. But I also do this since we spend 4 – 6 weeks per year on various vacations, missions, and short trips to see family and friends. It's a good balance that works for our family at this juncture.

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CHAPTER 6

Where to find the deals

Scott Meyers

Where to find self storage opportunities

Okay, so you're convinced you want to look at buying an existing self storage facility, but how do you go about finding suitable opportunities? Well as we've already discussed, with all of the advantages that self-storage facilities offer, this makes it difficult to find a number of facilities for sale compared to other property types such as single-family, multi-family, industrial, or other commercial properties.

Where do I find good facilities for sale?

Personally, I subscribe to the "shotgun approach" which embodies a number of different resources to locate properties. These sources include:

1. **Contacting a real estate broker who specializes in self-storage properties**.

   You can look in your local yellow pages, or search the internet for "self storage brokers" in your area. However, be careful not to enter into any exclusive agreements with him or her that would prohibit you from using other brokers. You're simply letting him or her know that you are in the business and actively looking for facilities that are available.

2. **Self Storage websites**

   There are a number of companies that specialize in self-storage facilities. An internet search such as "self storage for sale" will give you a good start on the various companies specializing in the sale of self storage facilities around the country.

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3. Mailers

There are local and national list brokers that possess databases of self storage facilities and owners per state and municipality. These can be purchased for a nominal fee to be used in conjunction with a postcard or a letter to be sent to the owner offering to buy their facility. Some examples of letters we have used in the past are listed below in the appendix, and on your forms CD:

IS IT TIME TO SELL YOUR STORAGE FACILITY?

Alcatraz Storage
Scott Meyers
1234 Storage Profits Dr.
Indianapolis, IN 46000
Scott@AlcatrazStorage.com

Dear Sam,

Many things have changed since you bought your storage facility at 1234 Main St., Anywhere, USA. Is it time to sell? If so, I can help.

I am a local investor who owns several self storage facilities like yours, and I'm looking to buy another one this month. As a property owner myself, I know there are many motivations to sell a property. I am willing to pay a fair price for your property, close quickly, or even delay the closing to give you more time if you need it.

Give me a call and let's talk about how I can save you thousands in real estate commissions and fees. There is no risk or obligation to you, and I'm confident we can find a solution that makes sense to both of us.

Call me now at (317) 506-4900, and we can discuss the sale of your property at the best possible price and terms. I look forward to hearing from you soon.

Sincerely,

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Scott Meyers

P.S. To get the best price for your property without paying commission, call me now at (317) 506-4900.

MOTIVATED BUYER NEEDS TO PURCHASE A SELF-STORAGE FACILITY IN 30 DAYS!

ALCATRAZ STORAGE
Scott Meyers, President
1234 Storage Profits Dr
Indianapolis, IN 46000
(317) 506-4900 Phone
(317) 634-7392 Facsimile
Scott@AlcatrazStorage.com

Dear Sam,

I am a local investor who owns several storage facilities like yours, and I'm looking to buy another one this month. I am willing to pay a fair price for your property, close quickly, or even delay the closing to give you more time if you need it.

Give me a call and let's talk about how I can save you thousands in real estate commissions and fees. If interested, I'm confident we can find a solution that makes sense to both of us.

Call me now at (317) 506-4900, and we can discuss the sale of your property at the best possible price and terms. I look forward to hearing from you soon.

Sincerely,

Scott Meyers

P.S. To get the best price for your property without paying commission, call me now at (317) 506-4900.

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I have generated a large number of leads in the past by using this method. In my home state of Indiana, I bought a mailing list of roughly 1,000 owners/facilities and I regularly send each of them a letter in a handwritten addressed envelope with an individual stamp (not a postage machine), so that it would appear as if it were personal mail. **I consistently receive approximately 30-50 responses, and of those 30-50, I end up with approximately 10 good leads.** This is by far my most successful form of lead generation, with approximately 75% of my apartment and self storage facilities being purchased using this strategy.

4. Cold Calling

Picking up the yellow pages in your area and calling each facility and talking to or finding out who the owner is can yield great results. The trick is to determine whether the person on the other end of the phone is the owner, or the manager of the facility. Many times, if it's the manager, they have been instructed by the owner not to give out his or her information, acting as "the gatekeeper" to keep you from getting through to the owner. But with some practice, you will become adept at striking up a conversation with the person on the other end to extract the information you need, and will begin to develop a database of owners to call on a recurring basis.

Tip: don't forget to ask if they know of other owners in the area that may be looking to sell. Most owners have intimate knowledge of their market and the status of their competition.

5. Site Visits

While traveling, I am always on the lookout for potential opportunities. If I happen to pass a facility that looks attractive, I'll often stop in and introduce myself as a fellow self storage owner. I'll ask the person behind the counter about the business and if they are the owner. Next, I will politely ask if they or the owner has ever considered selling the facility. If there is a level of interest, I'll ask when would be a good time to talk and then request a specific time to meet with my list of questions and due diligence questionnaire.

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Remember, if you strike out, don't hesitate to ask if they may know of other owners in the area that may be interested in selling their facility, and I **ALWAYS leave a business card**. I've received calls, sometimes several months after my initial visit, from an owner who is now interested in exploring the possible sale of their facility. Experience has taught me that time and circumstances change the minds of all sellers, so be persistent, it definitely pays off.

6. Local Newspaper

I regularly review the Commercial Property for sale and the income/investment property for sale sections of my local Sunday paper. There are a number of owners who know that there are investors actively looking for properties, and that they don't necessarily have to hire and pay a commission to a broker for listing and selling their facility. You can also take out an ad yourself in the real estate wanted section with the heading: **"I buy self storage facilities"** and a phone number. I have bought 2 properties from calls that I received from my postings in the real estate section of my local Sunday paper without having to employ the services of a broker.

7. Sell yourself

If you are truly in the market and have the ability to buy a facility, then it pays to let as many people as possible know that you are in the business. The greater the number of your peers that know you are actively looking to increase your holdings, the better your chances they will call you if they know of someone selling a facility due to Death, Divorce, Partnership Break-ups, Bankruptcy, Retirement, etc. In other words, become a living billboard and **flap your lips!**

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CHAPTER 7

Evaluating opportunities

Scott Meyers

DETERMINING VALUE

Eureka! Your Favorite broker has sent you a listing for a facility that appears meet your buying criteria, or an owner has contacted you and stated that they would like to discuss the possible sale of their facility. Now what? Below is a questionnaire I use to obtain more information about the property to determine whether it is worth making a trip to tour the facility and meet with the seller. I'll use this **"cheat sheet"** while I am talking to prospects on the phone so that I am certain I won't forget anything during our conversation, or waste any time driving to a facility that doesn't meet my investing criteria:

Self Storage Prospect Fact Sheet

Facility Name Owner			
Name			
Phone #		Fax #	
Email Address		Website	
Address of property			
Main St.	Construction	Fenced/Gated	Software
sq. ft.	# of units	Occupancy	Gravel/Paved
PM Software	Security	# of Bldgs.	Age
Acres	Vacant land	Boat/Rv Parking	Truck Rental
Competition			
Gross Rent	Other Income: Truck rental, Moving supplies		
Property Taxes			
Insurance			
Utilities			
Advertising			
Lawn/Snow			
Net Operating Income:			
Who handles the Management		Office on site?	
Population		Growth	

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Why are you looking to sell?
How much are you willing to sell for?
Are you willing to carry back a second mortgage?
Current Mortgage Holder

A word of caution however, not all sellers are willing to freely give you the information listed above, so tread lightly, and if they push back or become agitated, back off and request a meeting in person to tour the property. Every owner's comfort level is different, and many have had letters or calls in the past from pushy brokers or buyers that have caused them to be suspicious of your intentions, so proceed with caution; **the last thing you want to do is turn them off before you even get started.**

Now, let's go through each item to give some insight as to the relevance of each question.

Name of facility, owner, and contact info

For obvious reasons we need the name of the facility, and we also need to have a way to contact the owner in the future so that we can update our database of prospective sellers for future mailings and correspondence.

On a Main Street

Is the property on a main street with a high traffic count, or is it tucked back in an industrial park or possibly in a rural setting? Today's Self Storage customers want convenience, and an easy way to find you. In addition, your best advertising is visibility on a well traveled thoroughfare. So, if the facility is off the beaten path, you will expend a great deal more in yellow page and other advertising costs to generate traffic to a poorly located property. **A location on a main street with a traffic count of 10,000 or more cars a day is becoming a prerequisite for today's facilities.**

After I hang up the phone, I will enter the address into MapQuest (www.mapquest.com) to get an idea of the location as in the example below:

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This address is for the very first facility I purchased in a growing area outside of Indianapolis. What it shows is that it is located on a major thoroughfare in the path of progress on the outskirts of Indianapolis. What it doesn't show is that there are 2 very large residential developments under construction on both sides of the facility! The streets weren't finished at the time the map was posted on the web and therefore weren't listed.

So, don't discount the demand factor of ANY facility based on your initial data gathering phase including any preliminary maps.

Construction

Are the buildings made of steel, concrete block, pole barn style, or some other form of construction? Do they have steel or shingle roofs? If the buildings are steel, I always ask the name of the manufacturer to determine if they were built by a national, industry specific manufacturer or by a local steel building company. This will help to determine the quality and ultimately the marketability of the facility when we decide to sell. This doesn't mean that I won't buy a facility if the buildings are older and have shingled roofs, it just means that there are many things to consider when evaluating a facility for investment purposes and to adjust the value accordingly as we'll discuss in chapter 6.

Fenced or Gated

The goal of my company, Alcatraz Storage™ is to set myself apart from my competition, and staying true to my brand by providing maximum security. If the property isn't already fenced, I will be fencing it after acquisition. Fencing a typical, 4-acre site can cost up to $100,000, so be certain to figure this into your acquisition cost and loan request if you plan finance it up front, or begin budgeting for it out of the monthly cash flow after acquisition. Therefore, I want to know up front if the facility is fenced, and whether the

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gate is operated manually or electronically controlled. And if it's electronic, who is the manufacturer?

Software

I want to know the brand of gate and gate software in place so that I may determine if in will communicate with the property management software I currently use at all my facilities, or if I will incur additional costs to convert to my preferred gate and software vendor.

Square feet

How many square feet are located under roof (total square footage of all buildings)? This measurement will allow me to calculate the price per square foot based on the sales price and ultimately determine whether this falls into my target range for acquisition pricing. This is also a useful figure for calculating the overall economic occupancy level based on the current rent roll.

Number of Units

Much like square footage, we want to know how many rentable units are currently under roof to determine occupancy, and price per unit when calculating overall value based on market comparable (facilities that have sold recently). One Caveat, if the owner only has 1 or 2 buildings, with what you would consider a small number of units, don't be discouraged until you find out how many acres are included in the property. **This could be a perfect opportunity to buy a great piece of land that is already zoned for self storage that already has cash flow.**

Occupancy

For purposes of this discussion, we will compare occupancy based upon **the industry norm for a stabilized facility, which is widely accepted as 85%.** Occupancy levels below 85% are considered low, while occupancy levels above 85% are considered stable or high. The answer to this question opens up a number of related follow up questions. If the number is high, (86% or higher), I need to do a little more research to determine whether the prices can be raised, thereby providing an opportunity to increase the value should I decide to purchase the property. Or, is it in a high growth, high development area? If the occupancy is low (84% or below), I will ask the owner what he or she thinks may be contributing to the lower occupancy. There are a number of reasons

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including but not limited to why a facility may be experiencing low occupancy:

a. A declining population
b. Absentee owner/manager
c. Bad location – Low visibility, hard to drive to.
d. Older, unattractive facility with an undesirable unit mix
e. No amenities compared to competition – No fence, no security, gravel vs. paved, no retail office, etc.
f. High rental rates compared to the competition
g. Ineffective/absence of Advertising
h. Recently built a new building that is not stabilized yet (potentially a good attribute).

It is at this time that I will try to uncover any problems by asking some deeper probing questions to determine why this property has not reached its full occupancy potential. I am always careful, however, not to make the owner feel as if they have not done a good job of running their facility; they may or may not know it already. Besides, there may be other circumstances contributing to its poor performance, and those are the ones I will highlight and remind them of later in the negotiation stage.

Gravel or Paved

My brand, Alcatraz Storage, and our tag line, "Maximum Security Storage", demand that I set myself apart from the competition. All my properties have paved driveways with the exception of some of our RV areas. So, if a facility isn't currently paved, I have to figure that cost into the overall acquisition costs as I will surely pave the lot shortly after purchase. Even if all our competitors in a given market have gravel lots, this will give us an opportunity to present ourselves as a cut above the rest, and distance ourselves from the other owners who haven't listened to what today's customers now want and have come to expect. Paving costs vary from year to year, and depending upon what part of the country the facility is located. In addition, you can choose concrete or asphalt. To fully pave an existing 4 acre, fully developed site with asphalt can cost anywhere from $20,000 to as much as $60,000 depending upon total surface area and square footage.

Property Management Software

Do they currently use the same software that I have installed at all my facilities? If not, I will need to account for replacing this system and make sure that the gate software will communicate with my property management software as mentioned above.

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There are many property management software programs on the market for self storage facilities. Most are very similar in features and functionality, but differ in integration and support. Property management software packages may run as much as $5,000, or as low as $100/month for several of the internet-based programs available on the market at the time of this publication.

I discuss property management software in great detail in my Management and Operations home study course and boot camp.

Security

Does the facility have video cameras and or a video surveillance system? If so, what type? Is it an antiquated VCR system that needs to have tapes changed daily, or does it have the latest PC based Digital Video Recording (DVR) system with no need for daily management? If there is no system, or the one in place is obsolete, I will figure that cost into my overall acquisition as I will be installing a PC based DVR system with flat panel monitors shortly after acquisition. A PC based DVR surveillance system can be purchased for as little as $1,500 from one of the big box retailers, or can run as much as $10,000 for a truly state of the art system with flat panel monitors, and multiple cameras placed throughout a facility.

Number of Buildings

I will always ask how many buildings are on the parcel, what the sizes are, and the placement of the buildings on the site to determine the overall utilization of the parcel. As a reminder, even if the owner only has 1 or 2 buildings, don't be discouraged until you find out how many acres are included in the property. **Again, this could be a perfect opportunity to buy a great piece of property that is already zoned for self storage and currently has some cash flow in place with room for growth. *Remember, we're looking for value-add opportunities.***

Age

Certainly, we want to know the age of the facility and the buildings to get an idea of the useful life of the buildings. Typically, the age of the buildings will vary as most developers will stagger the construction of each building as the facility leases up. For example, most developers will generally build the first building towards the front of the property to maximize visibility from the road, while others do just the reverse, choosing to construct the main building last that will house a larger office and retail center as the

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property becomes stabilized and begins to cash flow. Either way, once a new building is constructed and overall occupancy reaches roughly 85%, most owners will begin construction on the next building. As a general rule, I don't read much into the age of the building until I perform the site visit to look at the quality and type of construction before making any assumptions.

Acreage

This is one of the most critical factors I use in determining whether a property represents an investment opportunity. I'm very eager to learn the size and shape of the lot, paying particular attention as to whether there is room to add more buildings. **I am always looking for ways to create value in a facility, and the best way of doing so is by erecting additional buildings if at all possible.**

Also, this is very useful information in the overall valuation as I may be apt to pay more for a particular facility if I have the ability to substantially increase the value by adding more buildings versus a property that is already stabilized with little opportunity for growth.

Vacant Land

We also want to know if there is any vacant land adjacent to the property that may be for sale for future expansion. Should the subject parcel be fully utilized, I will want to know if I can expand the facility by purchasing adjoining lots, combining the parcels, extending the fence lines, and adding more buildings.

Often times, adjoining land or lots can be purchased and utilized for expanding the facility, sometimes using the existing buildings!

Boat/RV Parking

Some municipalities require additional zoning to park and store boats and RV's. I want to know if approval is already in place, and if the facility currently offers parking for such vehicles. If so, how much do they charge and how big is the lot? Is it full, or is its underutilized **space that could be used to construct more buildings, which nets us more income per square foot than parking**?

I will also ask the owner if competing facilities in the area offer parking. If so, are they full? Is there an opportunity to construct covered or enclosed structures or perhaps even RV/Boat condos in the existing lot, thereby allowing me to charge a premium price compared to the market?

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These are all considerations when evaluating the additional acreage or parking areas of a potential opportunity.

Truck Rental

Does the facility offer truck rental services through a national, 3rd party vendor, or do they rent their own vehicle(s) in-house? Either way, is the program profitable, or is it a loss leader to bring in traffic for the rental units? I will talk in great detail later about the pros and cons of truck rentals in the self storage business in my Management and Operations home study course and boot camp, but at the very least, I would like to know if there are any contracts that have to be assumed, or if there is a truck(s) that would be included in the purchase of the facility. I have chosen to buy my own trucks, which run between $5,000 - $10,000 for a 20-foot box truck and an additional $500 for my signage to be placed on the sides.

Competition

When asking about the competition, I tend to get some incredibly varied responses. Some owners will tell me that they are the only game in town, while others will state that it's becoming increasingly more competitive with new entrants into the market at every turn. **Most owners possess intimate knowledge of their market and will give very candid feedback on the competitive landscape within their demographic.** I will also ask if he or she knows of any new facilities being constructed in the area that we may not be able to find in our own due diligence. This doesn't mean that we don't do our own research; this just gives us one more professional opinion from someone already operating in the market place. We always follow this up with a very thorough competitive market study which we will discuss in greater detail later in this home study course.

Gross Rent

We're now delving into the financial analysis of the property, which is where we begin to uncover the true value of the facility. **After all, what we're acquiring is an income stream, not just a piece of land with some buildings on it; the vehicle just happens to be self storage.** The following questions may seem a little invasive, but I will always try to get as much information about the property as possible before I just hop into the car and spend several hours of my time chasing a project that isn't a fit for us. Most owners will share this information as he or she knows what investors are looking for and that eventually, they'll have to provide it anyway to the appraiser and the lender if we are to move forward. Besides, they're investors themselves, right? However, if the owner will not disclose their financials, I will gracefully back off and offer to meet them at the

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facility, shake their hand, and have a face to face conversation before asking them to disclose their financials. Many owners want to feel comfortable that you are truly an investor interested in their property, and not a broker trying to get a listing, or a tire-kicker that doesn't really have the ability to close a deal if one were negotiated and agreed upon. Typically, the best way to achieve this is to arrange a face to face meeting at the facility.

Other Income

How much income does the property bring in with truck rentals, lock sales, moving supplies, packing/shipping, renter's insurance, etc? This could add as much as 5% in additional income to the bottom line, so I want to be able to uncover all income streams currently in place at the facility.

Property Taxes

Property taxes account for one of the largest portions of expenses for a self storage facility on an annual basis, so we want to be sure we have the correct and most current figure. I will also ask if the owner has ever tried to appeal the taxes in an effort to have them lowered and whether he was successful or not. This is generally not as successful as in other property types, but it can be done. I will also ask when the last assessment occurred, whether he or she knows when the next one may occur. Also, in many states, the sale of a property will almost always trigger a re-assessment and a subsequent increase in the property taxes going forward.

It is important to know how and when taxes are assessed in the markets you plan to invest in for this very purpose.

Remember, many of these facilities were purchased decades ago for the cost of the land only, and the sale of a property could trigger a major increase in the assessed value now that they have been developed, and therefore could trigger an increase in overall real estate taxes.

Insurance

Most owners can rattle off the annual cost of their insurance, and as you become more familiar with insurance costs on a per unit and per square foot basis, you can easily determine if the value is in line with the industry. I always ask if this includes any umbrella policies or other businesses the owner may be involved in which may account for an abnormally inflated premium. If so, I will still use this figure when calculating the value and

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negotiating with the seller, but it does make the property more attractive if we can peel away their additional coverage, and reduce the amount paid by using our preferred insurance broker and taking advantage of our multiple facility discounts.

Utilities

Fortunately, self storage facilities pay very little in utility costs, and they are much easier to budget for on an annual basis. Many facilities incur only electric expenses to run the security lights, the office, and electric gates. Medium to Large facilities will have electric, water, and perhaps gas if they have an office and/or climate-controlled units. **Be sure to ask the owner what utilities exist at the site and the annual cost of each if known.**

Advertising

Although most of the operating expenses in self storage are lower than other property types, advertising expenses are typically higher. Over the years, owners have found that your placement in the yellow pages results in a much greater chance of getting the phone to ring, and they will invest thousands of dollars to do so.

Costs vary dramatically by market, but it is not unusual for a medium size facility to spend from $200-$600/month just in Yellow Page ads. However, if the owner does not advertise, or they have a small ad, and their occupancy is low, this could present an opportunity to reposition the property simply by altering the marketing efforts of the facility.

I cover self storage marketing in greater detail in my “Self Storage Management and Operations” home study course and boot camp.

Lawn/Snow

This expense will vary greatly across the country. Some facilities in Arizona and New Mexico have no grass or snow to remove, while parts of the country have vast green spaces and high amounts of annual snowfall. What I mainly look for is whether the owner/manager handles these duties, or if they contract them out to a 3rd party vendor, and if so, what is the annual cost of each? During the due diligence phase, I like to see a 2-3-year history of financials, and this is an area I pay close attention to as this can vary greatly from year to year, especially if you live in an area where snowfall is prevalent.

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Net Operating Income

If the seller has given me a fair amount of this information, I can derive a rough estimate of what the net operating income is for this particular facility. I will then divide this number by the current market cap rate to get a baseline value of the property. This is the number that we will use for determining the value of this opportunity, and ultimately whether we decide to move forward or not. **Once I have derived the annual Net Operating income, I will divide this by .10, which represents a 10% cap rate, to give me a baseline value to work from.**

This is a quick calculation used to derive a value for most market conditions that will allow you to determine whether or not to move forward. We'll discuss valuation in much more detail in Chapter 6.

Now it's time to find out what the seller's asking price is, but first, a few more questions.

Who handles the management?

Does the owner actively manage the property, or does he have an employee(s), or a combination of both. I want to know if there will be an interruption in the operations should I purchase the facility from an owner/manager. In this instance, I will have to prepare for hiring someone to manage the facility in his or her place. If the facility has employees, this is the time to find out how many, and how their compensation is structured. *Again, this could be an opportunity to create operational efficiencies if the property is over pay rolled or if the current manager is not the right person for the job, thereby limiting the potential of the facility.*

We have purchased many facilities where the biggest opportunity for curing vacancies and maximizing the efficiency was reached by simply replacing the person behind the counter.

Office on site

Some smaller facilities may not have an office and therefore the leasing and management of the property is handled over the phone or from another location. I specialize in buying medium sized facilities (200-400 units) and prefer the presence of an office for a part-time or full-time manager to handle the operations of the business. So, if there isn't an office on site, I will determine whether the size and potential growth would support the construction of an office on-site for a manager to handle the management of the facility for me.

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Population

It is important to know the population in and around the municipality where the facility is located to determine the overall size of the market that this facility serves.

Growth

Most owners typically have a good grasp on what's happening in their particular market. I will ask if any new businesses have recently relocated to the area or if there have been any major economic development announcements made recently. Are there any new housing developments or Apartments being constructed nearby? The answers to these questions will help to determine if there is potential for an increase in demand for storage at this site or perhaps to support development of another site nearby.

Why are you looking to sell?

The answers to this question will vary greatly, but may provide a good indicator of how to proceed. If the states "Well, I'll sell anything if the price is right", then you may want to consider moving on to the next deal. But if the owner has expressed a real interest in selling **due to retirement, personal reasons, divorce, a move, or some other change in their personal circumstances, then you know it may be worth pursuing, all other things considered.** I ask this question also to spark more conversation and to build rapport. Many owners are very proud of their facility and may have owned and or developed it from the ground up, and refer to their facility as if it were one of their children. I will take time to Acknowledge this, congratulate them, and let them know that if you should strike a deal that you would take care of the facility just as well as they have.

Are you willing to carry back a second mortgage?

This question may be foreign to some owners, but if you don't ask, **you may miss an opportunity to buy a facility for $0 down.** In addition, some owners are fearful of paying capital gains taxes should they sell their facility that they have owned for a number of years, and would welcome carrying back a portion of their profit in the form of a 2nd mortgage to defer a portion of those taxes. With a simple but careful explanation, you can inform them that by carrying back a second mortgage, for say 20% of the purchase price, they won't have to pay such a high amount of capital gains taxes for selling. We'll talk more about how to structure a seller carry back mortgage in Chapter 11.

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Current Mortgage Holder

I ask this question for 2 reasons. The first is to find out if they even have a mortgage because then I know that I potentially have a greater deal of negotiating leverage if they don't have to pay off an existing mortgage. The second is to find out if their lender is one that I have already established a relationship with which will allow for an easier underwriting and approval process in addition to lowering my closing costs.

Ask for the appointment

If there is a level of interest on your part, and the seller's, then now is the time to schedule a site visit. I will generally ask them to bring a current rent roll, and hard copies of the insurance premium, the property tax record, rent roll, and a 12-month profit & loss statement from their property management software or accounting program to back up the figures they have given me in our phone conversation. I will also push for the appointment as soon as possible before they decide to "fish" the property around the market, or decide they want to list it with a broker.

Google Earth

After hanging up the phone, I will edit the fact sheet, and add any additional notes from our conversation. I will then look up the site on Google Earth (www.googleearth.com) to get a bird's eye view of the facility to determine the size, shape, road frontage, and basic appearance such as my Fortville Indiana facility shown below:

I will also perform a financial analysis of the property to determine the Net Operating income based on the preliminary figures obtained from the seller such as the example listed below in Table 6-1:

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Table 6-1

Sample Profit & Loss (Annual)

Income		
Rental Income		$120,624
Locks, Moving supplies		1,201
Total Income		**$121,825**
Expenses		
Real Estate Tax		$15,083
Insurance	3,802 Management	5,083
Utilities		3,107
Advertising		7,694
Repairs/Maintenance		4,034
Lawn/Snow		1,459
Trash		1,037
Total Expense		**$41,299**
Net Income		**$80,526**

Capitalization Rate (Cap Rate)

Commercial properties, which include self storage facilities, are typically valued in terms of their capitalization rate or Cap Rate that we touched on earlier in the chapter. The cap rate is the ratio of net operating income to sales price:

$$\textbf{Capitalization rate} = \frac{\textbf{Net Operating income}}{\textbf{Sales Price}}$$

As you can see, this ratio is really a very simple calculation used to measure the relationship between the income generated by the property and the price it is being sold for.

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Summary

A copy of my prospecting fact sheet is enclosed in the Appendix and on the forms disc for your use in part or in full. Feel free to modify according to your comfort level, but I urge you not to stray too far or you will run the risk of running off on the proverbial “wild goose chase”. Now, with the property information in hand, we will move on to the next step, which is analyzing the market the facility serves.

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CHAPTER 8

Market Analysis

Scott Meyers

Now that we have identified a potential opportunity, the next step is to begin performing some due diligence with regard to the market it serves. **All real estate is local.** The health and well-being of a real estate investment is affected more by its position in the local market and the health of that market than any other element. Factors such as location, population, income, and employment levels directly affect every type of real estate. It warrants saying again, the old line of thinking **"build it and they will come" no longer applies in today's competitive landscape.**

Market information is collected from a variety of sources. Each level of information is useful, but we frame the data in the context of applicability to our investment objectives before we draw conclusions.

Location

There are times when I may choose to drive by the facility before meeting with the seller to gauge whether it fits my definition of a "desirable location". Is it really on a main road with decent visibility and a high traffic count as he or she described over the phone? What is the area surrounding the property like; is it in a growing retail or residential area, or is it tucked back in a decaying industrial park surrounded by vacant buildings? After surveying the location, I will make a visit to the local economic development office or town planning office to see if there are any new developments considered in the general area surrounding the facility. And if not, what areas in this community may be experiencing growth, if any. **And I always ask if there are any new self storage facilities under construction or in the planning phase or awaiting zoning approval.**

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Population

Obviously, an area with a growing population is a plus, but the raw number for population change over a period of years isn't enough information to draw conclusions. These reports are drawn from census data, which is updated every ten years. The longer it has been since the last census, the higher the probability of error in the present estimate of current population. There are other ways to get a more updated population estimate for a given area. One service that has been available for years is www.sitereports.com. A quick search on the web will result in dozens of companies that offer demographic services for a fee. Also, if you have the luxury of possessing a real estate license, you have a wealth of information at your fingertips from your board of realtors relating to demographic reports for the area in which the facility is located. A source for free demographics reports is LoopNet, the mega-listing site for commercial real estate (www.loopnet.com). They include a general demographic report for any listing that supplies a street address, though the report does not contain a lot of detail. This can be a quick way to check general population and income trends for an area, and as a comparison for a paid report. Some Economic Development and town planning offices have updated demographic reports as well, so don't forget to ask for any collateral they can provide when you visit their office as we discussed earlier.

Employment

It has been said that real estate values are all about jobs. **Follow the jobs, and you'll find the people.** Those people have needs, and the job provides the income to fill those needs. Beyond a place to work, they need places to live, shop, congregate, and store their "stuff". Our role as investors is to supply those places where and when they are needed, at a price the market will support.

When considering employment data, it is good to be aware of national trends, especially industry-specific conditions. To state the obvious, if employment growth in the market is stronger than the national average, the economy is up. If it is weaker, the economy is down. If it is significantly below the national average, the local economy is in bad shape. **The most important numbers are job growth, defined as the numbers of new jobs created, and the level of unemployment as a percentage of the work force, commonly called the unemployment rate.**

Beyond the hard employment numbers, look for other signs of growth. Growth areas show job gains in professional and service sectors, usually led by the former. Local papers regularly announce new business openings, new shopping centers, new residential developments, and the like. Growth pressures on utility and transportation

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infrastructure will be the topic of discussion in city council meetings. Rezoning activity will be at a high level compared to past years, and building permits will be on an upward trend.

This doesn't mean, however, that I only look at areas with a high growth rate of jobs and therefore development. I pay closer attention to the historical performance of the property, and how it has weathered the past economic cycles. **One of the biggest benefits of self storage is the fact that it is somewhat insulated to economic cycles compared to other property types**. When the economy is up, people and businesses buy more and therefore need to store more. When the economy is down, people and businesses tend to downsize their homes and offices, and therefore need to store the extra "stuff" they don't have room for in our self storage facilities. I am not minimizing the approach to Market Analysis that we have just discussed, but it may not be as critical to the success of your potential self storage facility as it is when investigating the acquisition of other property types in a given area.

Industry Reports

Fortunately, there are trade associations in the industry that have done a remarkable job performing a number of market studies, and making those findings public. The Self Storage Association has a wealth of industry and market information that is readily available and fairly inexpensive.

One such tool is an Online Self Storage Demand Estimator available from the National Self Storage Association, or ODESSA for short. It is a unique technology tool that estimates demand for self storage in any user-defined competitive trade area in the U.S. It is based on a proprietary model that uses information from the Self Storage Association Demand Study and commercially-available geographic databases. The Self Storage Demand Study surveyed 2,150 household storage renters and 383 business users which serve as the basis for the estimator.

To purchase a report, you can go to the Self Storage Association Website at www.SelfStorage.org, and click on ODESSA. You can then enter the address or zip code you are interested in and order the report which is emailed to you in an EXCEL® file. The price at the time of this publication was $75 for SSA members and is, in my opinion, a bargain for the information it provides, especially if you tried to do this yourself. The report provides a map of the competitive trade area you defined and the population characteristics within that map. Most importantly, it also shows consumer and business segments and self storage demand for segment within the designated area and by zip code. In addition, it identifies and maps out existing Self Storage facilities in the area for

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comparison and proximity. One of the nicest features is that it contains user-modifiable parameters to tailor the figures in the report.

Once I have this report, I first look to see population figures in and around the facility. **Ideally, I'd like to see 5,000 people living in a 1-mile radius, 40,000 within 3 miles, and 80,000 in 5 miles. I'd also prefer a Median income of $45,000 and a traffic count of 10,000+ cars per day. I'd also like to see 25% of the housing to be multi-family.** A sample ODESSA report for our Brownsburg facility is located in the Appendix and on the forms CD.

In addition to this report, I will Google "Self-Storage" in the market to verify the data just in case a new facility has opened that is not included in the ODESSA report. I will then print the list of facilities along with a map showing their locations, and will schedule some extra time to drive by or visit the various facilities within 5 miles of the subject site before or after my appointment with the seller. The goal is to size up the competition based on a number of factors.

First, how close are they to the subject site? Do they have better visibility or road frontage? Are they newer, well maintained, or more aesthetically pleasing from a curb appeal standpoint? Are they locally owned or part of a national chain? Do they offer more amenities in the way of fencing, security, retail supplies, a business office, truck rental, climate control, etc.? Are there visible signs of new development or revitalization of the area surrounding the facility?

In other words, do I face formidable competition in a decaying part of town or could I position this property to be the premier facility serving a growing community?

If you don't feel comfortable moving forward after performing your own research, I will again suggest you contact one the many self storage consultants in the country to perform a feasibility study for you. You can search for one in your area by typing "self storage feasibility study" in your web browser.

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Self Storage Profits Inc.

Self storage Acquisitions

CHAPTER 9

Making the Offer

Scott Meyers

Negotiation

Once you have identified a property that meets your investment criteria and have determined through your preliminary research and analysis the approximate price you are willing to pay, the next logical step is to negotiate for the best possible price and terms. Negotiating the purchase price and terms of your acquisition requires a combination of art and skill. **As in poker, you must be careful not to reveal your own hand, while simultaneously attempting to force the hand of your opponent.** There are a number of ways to approach this phase of the buying process that can be successfully implemented as we'll discuss below.

Engage a broker

One such strategy involves working with a competent broker to broker the transaction for you. Many owners of self storage facilities tend to have a deep level of emotional attachment to their properties. They have likely owned their properties for a number of years and have personally devoted a great deal of time and energy developing them. They have worked hard to stabilize and maintain their facilities and have considerable resources invested in them. As a prospective buyer, you can say things to the broker that you may not choose to say in the presence of the owner. The broker's role is to strive to eliminate the emotional aspects of negotiating by acting as an intermediary for the buyer and seller. A seller offering his facility for $1 million may take offense to a buyer offering a low-ball purchase price of only $700,000, and may choose not to respond at all. A broker, however, may encourage the buyer to offer more, knowing the mindset of the seller, in an effort to keep the negotiations moving forward.

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Remember, the broker has a strong incentive to keep the deal going; the commission! No deal, no commission.

Conversely, I have acquired most of my facilities without the assistance of a broker. I prefer to uncover the opportunities myself before a broker has a chance to educate the seller as to how they (the broker) can get them top dollar for their property if they list it with him or her. In addition, brokers are simultaneously working with several other individuals, and simply can't focus 100% of their efforts on finding a property that meets my criteria. Therefore, although I let brokers know when I'm in the market for another property, that doesn't mean I shut down my internal prospecting machine. Besides, if I beat the broker to the punch, **I can save the seller some commission which I'll use as a negotiating tool to lower the price by a percentage of the sales commission I have saved them!**

Justify Your Offering Price

By the time you are ready to make an offer, you should have reviewed the seller's financial figures and formulated a fairly definitive Net Operating Income figure for the facility as we discussed earlier. This value is the basis for your offering price. Using the figures from our example in Table 5-1, if a seller is asking, for example, $1 million for the facility, and your analysis indicates a value of only $800,000, you should use that information to your advantage by explaining to the broker or to the seller why the subject property is worth that amount and no more. Walk the broker or the seller through your analysis, using the same figures that he or she provided to you, to help them understand why you believe the value is only $800,000.

Table 8-1
Sample Profit & Loss (Annual)

Income	
Rental Income	120,624
Lock, Moving supplies	1,201
Total Income	**$121,825**
Expenses	
Real Estate Tax	15,083
Insurance	3,802
Management	5,083
Utilities	3,107
Advertising	7,694
Repairs/Maintenance	4,034

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Lawn/Snow	1,459
Trash	1,037
Total Expense	**$41,299**
Net Income	**$80,526**

Because cap rates vary dependent upon interest rates and are somewhat subjective, I recommend starting below your target price of $800,000. If in this example, the net operating income (NOI) is $80,000 and the market comparable suggest a cap rate of 10.00 percent, then

$$\text{Cap rate} = \frac{\text{NOI}}{\text{Price}} = \frac{\$80{,}000}{0.10} = \$800{,}000$$

As you walk the seller or the broker through your analysis, simply state that you believe the property falls into the 10 to 11 cap rate range, and that at a cap rate of 10.5, the property is worth only $761,905; therefore, you want to start the bidding at $760,000.

$$\text{Cap rate} = \frac{\text{NOI}}{\text{Price}} = \frac{\$80{,}000}{0.1050} = \$760{,}000$$

I would like to make a very important point here that should be taken very seriously, and considered when analyzing all commercial deals: **You should be willing to pay a price based only on how the property is operating today, not based on how the seller or broker tells you it can potentially operate in the future.**

The seller or the broker is going to tell you every reason he or she can think of as to why the facility is worth the $1 million the seller is asking. You politely but tactfully explain to the seller or broker that if the property were truly worth the full asking price, then it should be generating a minimum of $100,000 of net operating income today; not tomorrow, not in a year from now, but today. If all of the potential the seller or broker claims to be in the property truly exists, then why has the current owner not achieved that level of performance yet? Why is the property generating only $80,000 of NOI instead of $100,000?

Furthermore, why would you pay the seller for the future value of the property? **You are the one who has to spend the money to properly market the facility, and a fair amount of time and work to bring the property up to its potential; therefore, you**

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should get paid for your troubles, not the seller! These are the types of arguments to make to support your position. The more knowledgeable sellers and brokers that correctly comprehend value will better understand your position and tend to agree with you, while those sellers and brokers with limited experience may not. For those with limited knowledge, it will be up to you to educate them.

Know why the seller is selling

As a prospective buyer, it is important for you to know why the seller wants to sell his or her facility. Knowing the reasons for selling can potentially give you an advantage at the negotiating table. Is the seller a tired owner/operator just trying to get rid of the facility (and the headache of operating it) or is the seller simply testing the waters to determine what price the market will bear?

In other words, **you want to determine whether your seller is *motivated*,** and if so, to what degree. The more motivated the seller, the more likely the seller is to be flexible on both price and terms.

The reasons for selling typically fall into one or more of the following six categories:

Eight Reasons Why Owners Sell their Facility

1. Need their equity for another investment opportunity
2. Burned out due to poor management
3. Retirement
4. Tax Implications
5. Changes in economic conditions
6. Life-changing event
7. Extensive Capital Improvements
8. Increased Competition

1. Need Equity

One of the most compelling reasons for a seller to divest property is that they are a value player who is ready to invest in their next big deal. The degree of motivation will vary depending on factors such as how much value was created and the timing to purchase the next investment. If the seller created $250,000 in value on a $1 million self storage facility over a 12-month duration, the seller may be willing to accept $925,000, thinking that a bird in the hand is better than two in the bush. In other words, instead of holding out for the full $250,000 in profits-which could take as long as another six months

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to a year-the seller can go ahead and accept the lower price, lock in a gain of $175,000, and be ready to move on to the next deal. You may think that $75,000 is a lot to leave on the table, but a value player is thinking about the next deal and the $300,000 to $500,000 he or she will make.

2. Poor Management

Poor management is another primary reason why sellers look to dispose of their facilities. The degree of motivation will directly coincide with the seller's degree of stress. You can pick up on subtle clues by engaging in conversation with the seller, and tactfully uncovering his pain. A site visit with the seller can be very revealing. Is the property poorly maintained and in need of some TLC?

Is the seller anxious, frazzled, or frustrated with the manager and maintenance person? The financial statement can also be very telling. Is the occupancy lower than the competing facilities in the area? Is the tenant turnover high at this facility? All of these indicators can be helpful in determining the motivation of the seller, and ultimately, his or her level of flexibility.

3. Retirement

At some time in every person's life, they reach a point at which they are ready to slow down, and enjoy the fruits of their labor all their working years. This is typically an easy one to uncover as most owners are proud of their facility and will openly share the fact that they have made the decision to finally retire. The degree of flexibility will vary depending upon each individual owner's situation, but asking more questions may lead to the owner's desired timeframe to sell the facility.

4. Tax Consideration

Another reason for selling a facility is the seller's tax considerations. If the seller is involved in a 1031 tax deferred exchange, then the seller is limited by law to a fixed number of days to identify another property and subsequently close on it. These strict time constraints can impact the seller on both ends of this transaction, meaning the sale of his current facility and also the acquisition of the new one. If the seller has not identified a new property to purchase, the seller may not be too motivated and may decide to stall the sale.

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5. Changes in Economic Conditions

Changes in economic conditions, for purposes of this home study course, are changes that occur outside of and unrelated to a specific facility, but may affect the property either positively or negatively. A shift in demographics, crime, employment trends, or competition, for example, are all changes over which the owner has no direct control, but which may still affect the operations of the facility. The facility owner may have been doing an excellent job managing the operation, but perhaps a plant closing or an increase in crime will have a negative impact on the facility's level of profitability. As a buyer, it is important for us to know these factors as well since they will be the same for you as the new owner.

6. Life Changing Event

Life-changing events can immediately and radically alter a seller's situation. These events may include such things as the death of an immediate family member, divorce, or illness. I am always careful when I discover that this is the reason for a seller disposing of his or her facility. I typically slow the pace of negotiation preferring to sit back and do a great deal of listening while being careful not to ask too many questions for fear of striking a nerve.

7. Capital Improvements

Even though Self Storage is a low maintenance business, if an owner has an older facility in need of repairs, he or she may simply not have budgeted for replacing the roofs, repairing the parking lot, fixing or upgrading all the doors, fence, gate, etc. Faced with having to make these improvements out of pocket or selling the facility, many owners choose the easy way out, yet again, creating another acquisition opportunity for us.

8. Increased competition

As self storage continues to grow in popularity, so do the number of entrants into the industry. In some areas, many of the mom and pop operators are being squeezed by the medium to large players who are developing newer, state of the art facilities. Owners who once enjoyed consistent 85-100% occupancy at their facilities may decide to throw in the towel now that their occupancy is being affected by competition. Rather than invest in their facilities and face the competition head on, many times they will elect to simply sell off their holdings and move on.

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Presenting the Written Offer

We will now be working from sample documents for purposes of this discussion. The full documents are available-*as demonstration exhibits in sample form only*-on the forms CD.

***These documents are included for demonstration and discussion purposes only. The author takes no responsibility for their use. No document contained herein has been reviewed or approved for use in any state or jurisdiction. There are no warranties either expressed or implied regarding the suitability for use of the documents in any jurisdiction, transaction, or proceeding. The author expressly states that he is not an attorney and has no qualification to render legal opinion. The opinions expressed herein are those of the author, and as such are not to be relied on for any legal matter or decision. It is recommended that you retain competent legal counsel before entering into any contract or agreement. In Self Storage*, which is a form of commercial real estate, it is imperative that you find good counsel to assist you with the proper documents to conduct business in your state. In addition, it is recommended that you discuss with both your attorney, and a competent CPA how to form the best legal entity to purchase the facility that will reduce your liability and provide the best tax advantages.** I could discuss a number of ways that I have used, but since every state is different, and the laws change so frequently, and every investor's situation is different, I will just strongly urge that you utilize 2 competent legal and financial professionals in your area as you move forward. Most attorneys will have existing agreements and contracts that are "boiler-plate" documents used for the bulk of these transactions, and therefore aren't as expensive as you may think. And I will strongly urge that you **DO NOT go to the local office supply store and buy a pre-packaged purchase agreement for purposes of buying commercial real estate!** I could list several examples of deals gone bad because a buyer decided to take the cheap route with regard to their purchase agreement and other legal forms, but I'll just continue to stress that this may cost you several times more money in the long run just because you tried to save a few bucks up front. The standard practice in commercial real estate is for the buyer to supply all documents that provide for the purchase of the property. I prefer to use my own documents when buying or selling simply because I am familiar with them. In addition, many unsophisticated sellers will prefer that I just handle this part of the transaction since they don't possess such documents or feel they may have to pay someone to do so.

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We will now discuss two of the most common documents used in self storage real estate transactions in the order they are presented to the seller. These include the Letter of Intent (LOI), and the Purchase Agreement.

Letter of Intent

If a property makes it through the first cut, protocol varies as to the next steps being taken. If a Letter of Intent (LOI) is required to move the deal forward, we should be prepared to supply one. The LOI serves 2 purposes:

First, it gives us some assurance that the property will not be sold to another party while we are performing our due diligence.
Second, it gives the seller assurance that we are serious about proceeding with the purchase and establishes a timeline and milestones for the transaction to move forward.

My LOI is a simple 3-page document that covers the basics of the transaction and generally softens them up before I send the 6-page Purchase Agreement with all its demands and lengthy legal verbiage. The example listed below is a general format and can be modified as you and your attorney see fit. I have also provided a copy in the Appendix and on the forms CD.

The LOI should cover the basics of spelling out the parties to the transaction, the property, the price and terms of purchase, and the timing to complete the sale. It is a short-lived agreement that covers the period between initial contact and the execution of a legal contract to purchase. It may also include other specifics relating to the parties involved, the property, or any contingencies requested by the buyer, and a preliminary list of items required to complete the due diligence.

LETTER OF INTENT TO PURCHASE

AAA Self Storage
1234 Main Street,
Anywhere, USA 56789

Dear Mr./Mrs. Seller:
This letter will serve as a non-binding Letter Of Intent to purchase the above referenced property located in Anywhere USA under the following terms and conditions:

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Buyer	Scott A. Meyers, Alcatraz Storage, LLC 1234 Self Storage Profits Dr. Indianapolis, IN 46201 (555) 555-5555 Ph. (555) 555-5555 Fax Scott@AlcatrazStorage.com
Seller:	John Steel
Purchase Price/Terms:	Six Hundred Twenty Thousand Dollars ($620,000) to be paid in cash at closing.
Due Diligence	Thirty (30) days Inspection period, then 45 days to close after receipt and approval of required third party reports (i.e. appraisal, title, survey, environmental, etc.)
Closing Date:	On or about March XX, 20XX
Escrows:	Five Thousand Dollars ($5,000.00) to be deposited with XYZ Title Insurance Company within 5 business days of acceptance of this letter of intent. This amount shall be refundable until expiration of the Inspection Period, and in the event that the Purchaser is denied permission to assume the mortgage or not offered a new loan to purchase the property from another lender as planned.
Subject To:	Physical inspection of site/property acceptable to Buyer. Negotiation and execution of a mutually acceptable Purchase Agreement containing normal contingencies to be completed no later than January XX, 20XX Review and approval of a Phase I Environmental Survey or updated or dated not less than twelve (12) months prior to the Closing Date.
Documents Needed To Close Checklist:	The Seller to provide copies of the following to Buyer: a) Seller's existing ALTA extended title insurance policy. b) Seller's existing Phase I Environmental Survey dated or updated not less than twelve (12) months prior to the Closing Date c) Seller's existing appraisal d) Seller to pay one half of the closing fee and one half of the transfer taxes. e) All additional pertinent environmental, structural and engineering reports regarding the property in Seller's possession f) All plans and specifications.

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g) Such other documents as may be specified in the Purchase Agreement

Inspection Period: Buyer shall have twenty-one (21) days after full execution of a Purchase Agreement, at which time Seller shall deliver the pertinent documentation or Due Diligence materials, (the "Inspection Period") to conduct all necessary document examinations and inspections of the Property. Buyer shall indemnify, defend and hold Seller harmless from and against any and all liability, loss, damage, claim, cost or expense which may result from any entry upon or inspection of the Property by Buyer, its employees, agents or contractors. During such Inspection Period, should Buyer find any unacceptable condition, the Purchase Agreement may be canceled, in writing, at Buyer's discretion, and all Earnest Money shall be refunded. If, however, the Buyer does not cancel the Purchase Agreement, the Seller shall retain the earnest money, which shall be applied toward the Purchase Price at Closing, or shall be forfeited to Seller in the event the Buyer does not close on the sale.

Brokerage Fees: Seller shall be responsible for Brokerage Fees in the event he/she chooses to utilize a broker's services regarding this transaction.

Acceptance: This Letter of Intent shall be open for acceptance until December XX, 20XX at 5:00 PM.

This Letter of Intent shall not constitute a binding offer to purchase or a binding offer to sell. If the terms stated above are acceptable, please sign and return this letter in the space provided.

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AGREED AND ACCEPTED:
SELLER

By: ______________________
____

Its: ______________________
____

Date: ____________________
____

AGREED AND ACCEPTED:
BUYER

by:

Its:

Date:

As you can see, the LOI does not obligate either party to specific actions for the purchase and sale of the facility. It does, however, obligate the parties to perform as agreed, the process moving forward and timeframes. The terms can always be modified to suit any particular situation, keeping in mind the basic price, terms, and timing that I will include in the purchase agreement.

Some sellers may refuse to release the due diligence materials until there is an executed purchase contract. I have had this happen to me and you just have to accept that some sellers are not acquainted with the customary process involved in a traditional commercial real estate transaction. It's not a deal killer, they may just want a little more assurance that you are serious, you have the financial means and ability to close, or some level of confidence knowing that you are not just a broker looking to solicit a listing.

In addition, **you certainly don't need a LOI to complete the transaction, and in some cases, it may be better to get the purchase agreement executed before they change their mind and shop the property around!** Remember, the executed (signed) purchase agreement is binding, the LOI is not.

Purchase Contract

The purchase agreement is arguably the most important document an investor will ever sign. It spells out the details of the transaction, identifies the property, the parties involved in the agreement, the consideration and how and when it will be paid, and the recourse available to the parties in the event of default of the contract. In the event of any dispute between the parties, the contract spells out the manner of resolution. In the event the deal really goes south and you land in court, the language will be scrutinized with an unbelievable amount of detail. It is critical that you understand your position with regard to your performance and responsibilities as the buyer.

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The Purchase Agreement included in the Appendix and on the Forms CD is an example of a typical real estate contract. It is created with a slight buyer bias, but it fairly protects the interests of both parties to the transaction. Rather than reproduce the contract here in the text, I have chosen to discuss certain points of interest as you present your offer. And please remember, the Purchase Agreement is for sample purposes only so please **contact your local attorney to draft a contract that is applicable to the state in which you will transact business.**

Earnest Money

In a typical commercial real estate transaction, it is customary to deposit 3-5% of the purchase price as earnest money. When I write my offer, I will typically try to **deposit the least amount of money possible**, sometimes as little as $1,000, to avoid tying up too much of my working capital.

Conditions of Sale

45 days may seem like a long time to obtain approval, but I want to leave myself as much time as possible should the bank need more time or if any of the third-party reports are delayed. I am at the mercy of the bank's underwriters, and the busy schedules of the appraiser, surveyor, environmental engineer, and the building inspector. I prefer to give myself more than enough time to complete the transaction, rather than set any false expectations.

The Loan to Value Ratio section spells out the type of loan we plan to seek. 80% Loan to Value (LTV) is the standard percentage for a commercial real estate transaction including self storage facilities, and this example represents a typical deal. We'll discuss other financing options and techniques in further detail in Chapter 11.

The leased property Addendum which is located in The Appendix and included on the forms CD lists the items needed to complete our due diligence. This information will ultimately be forwarded to my bank and the appraiser to complete their analysis of the deal as well, so timeliness is very important. It requires the seller to provide copies of all the leases in order to verify the actual rental income being generated by the facility at the present time. It also requires the seller to list all the personal property that will be conveyed to the buyer at closing. These are negotiated items, but typically **I will ask for everything in the leasing office and the maintenance unit that is currently being used in the day to day operations of the facility.**

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I will include this on my purchase agreement, and attach a separate personal property addendum as part of the transaction. A sample of my personal property Addendum is included in The Appendix and also on the forms CD.

I will also ask for a 30-day coaching period in which the seller is required to make themselves or the facility manager available to properly transition the property. It takes at least this long to become acquainted with the facility and the tenants if I am not willing or able to hire the existing facility manager.

Closing

I will typically allow 90 days to close to ensure that I have ample time to line up my financing, down payment, and for all the 3rd party reports (appraisal, inspection, survey, and environmental) to be completed. I can typically get this all done in 60 days, but I like to have a buffer should some unforeseen challenges arise that are beyond my control. The time of the month for closing can also have a significant impact on the rent credits I am entitled as the buyer. Suppose I close on the very first day of the month. Although I am technically entitled to receive the full month's rental proceeds at closing, it is unlikely that the seller will have collected the bulk of that month's rent as of yet. In addition, most owners provide a two to five-day grace period before rents are considered late. If the seller were to give credit for the full month, this would put the seller in the position of having to collect the remainder of the rent after the date of closing when he or she is no longer the owner. **I believe it is better to wait until the fifth of the month or so. By this time, over 95 percent of the rents should be collected and as the buyer, you will be entitled to receive a prorated credit for 25 days' worth of rent without having to expend the time and effort to collect them. Conditions to closing**

Title work

Even though my contract states that the title work is to be ordered by the seller, I will often request in the purchase agreement that the title work, escrow and closing be performed at **the title company of my choice**. Once you find a good title company, it can make your life, and especially your closings, much easier. The expense is still the seller's, as it is customary and ultimately their responsibility to provide you with marketable title to the property.

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Survey

Likewise, it is customary and the seller's responsibility to provide a survey if possible, showing the boundaries of the property. However, it is typically the buyer who pays for the survey as a requirement of his lender. In either case, **I will always ask for the seller to pay for it**, and many times they will agree, or it simply shows up as a deduction on the closing statement from the seller's proceeds. In addition, I will always ask the seller for a prior survey that could be used if it is a recent report and no changes in the property have occurred, and schedule the same appraisal company to come back out and re-certify or update the existing survey at a lower cost.

Inspections

Each and every property you purchase should be inspected by a licensed inspector. I have skipped this process several times in my career, and several times it has come back to haunt me. **Unless you are a professionally trained inspector, then I strongly urge you to hire one to inspect each and every property you are looking to purchase.** Improper roof seams, heaving cement slabs, poor drainage, and other structural defects are items you don't want to correct after you have already purchased the facility. Surveys vary in cost depending upon the size of the facility and the scope of the work involved. For a typical 25,000 s.f. facility without climate control units, you can expect to pay around $2,000 to $2,500.

Phase I Environmental Reports

Phase I Environmental Reports have become the standard for almost any loan from any source. An Environmental Phase I Assessment is an inquiry conducted to determine the environmental status of a property or facility in connection with a real estate property transaction. The Phase I report includes a review of public records and databases maintained by each state and the federal government for environmental "events" or known contaminations on the property or in the immediate vicinity; interviews with all owners available in the chain of title for a specified number of years; and a visual inspection of the property. Included in the review is a LUST (Leaking Underground Storage Tanks) survey for the site and the area within a one-to-three-mile radius to determine if there is any downstream risk to the site from known hazards. Based on the findings from the review of public records, a conclusion will be offered as to whether or not any further action is recommended. If no further action is called for, the site is referred to as "clean", the report is delivered to the owner and lender, and the file is closed. The expense of this report is typically born by the buyer as his lender will be the one requiring the report. It is helpful to ask the seller if he has a prior report that could be used, or at

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the very least, to use the same company to come out and update the report at a reduced cost. Some sites may be found to have low levels of contamination, but depending upon the bank's viewpoint, this may not be an issue for a self storage facility since this property type is not conducive for people to inhabit, and provides no real danger to anyone driving in or out of the facility. Some facilities are built on former industrial sites or near railroad tracks which may present a problem, but it has never stopped me from purchasing the facility, so long as there is not an issue with the Phase I report.

Buyers and Sellers Expenses

Typically, the Seller pays for releasing his loans, recording that release, preparing the deed, Vendor's Affidavit, paying his or her state income taxes, and **½ of the Closing fees.** Again, I have written in my purchase agreement for the seller to pay the entire closing fee. Sometimes the seller will agree, and other times it will be negotiated.

Either way, it's just one more way I try to keep my acquisition costs to a minimum. Buyer's expenses typically refer to the cost of the loan, and the other expenses we previously discussed and ½ of the closing fee.

The rest of the purchase agreement is fairly typical of most contracts for the purchase of commercial real estate. I would like to stress once again that this is a sample contract for discussion purposes only, and that you and your attorney should draft and use a purchase agreement that is applicable to the state(s) you will be doing business in.

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Self Storage Acquisitions

A step by step guide to creating wealth in self storage

CHAPTER 10

Due Diligence

Scott Meyers

The topic of due diligence is not very glamorous, but it is **THE most critical aspect that will determine your success in this business.** Due diligence is the discovery phase of investment. This is where we determine whether or not the investment is suitable for our investment aims before we write the big check. **It's not what we know that will cause problems in our investing career; rather it's what we don't know that inevitably leads to disaster**. Our job is to gather all the information we need to make informed decisions regarding a property within the confines of the often times adversarial relationship of buyer and seller. During the inspection period, we gathered a fair amount of data, and our purchase agreement outlines a full list of items needed to perform our Due Diligence. The following checklist is what I use as a reminder to at least ask questions concerning the item in question. This is not something I will give to the broker or the seller to fill out; rather, it is for my own use when evaluating a facility. A copy of this checklist is included in The Appendix and on the forms CD.

Due Diligence Checklist

General Information

Facility Name: ________________________Year Built: _____

Address: _____________________________________ Building Size

______________S.F ____________________# of Units

City: ______________________________ **County: __________________ State: ____**

Telephone: _________________________

Manager: _______________________________________ Financial Information

	Notes
Annual Operating Statements (3 Years)	
Monthly Operating Statements	
Tax Returns (3 years)	
Budget Forecast	

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Existing Loan Documents	
Bank Statements (1 year) (Optional)	
Security Deposit Account Statement	
Utility Deposits	
Miscellaneous	

Operating Information

Copy of all Leases (original leases delivered at closing)	
Rent Roll: (Current and past 3 years) Start/end date, rate, deposit, payment history per tenant	
Tenant File Examination: Application, Lease, Security Deposit, credit report, payment history, complaint history, etc.	
Concessionary Rents	
Lease Expiration Report	
Utility Bills (two years, showing usage and cost) Water, Sewer, Gas, Electric, CATV, Ethernet, Phone	
Property Tax Rate Sheet (3 Years)	
Service Contracts (Trash, Exterminating, HVAC and Elevator maintenance, Snow removal, Lawn care, Advertising etc.)	
Vendor Agreements	
Operating manuals (phone, computer, fire system, etc.)	
Insurance: Policy (premium disclosure)	
Insurance: Claim History (past 3 years)	
Insurance: Carrier Risk Assessment	
Management Contract (if any)	
Miscellaneous Agreements (Vending, Pay Phone, etc.)	
Capital Improvements and Maintenance History (3 years)	
Warranties: (HVAC, Roof, etc.)	
Telecommunications provider- ______________________________	contract Yes | No

Legal and Physical Information

	Notes
Copy of Deed and Legal Description	
Title Policy	
Tax Assessment: Land/ Building	
Architectural & Engineering Plans— Survey	

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Building Type (metal, block, other)	
Office Space sq. footage	
Land Area/ Building Area __ coverage % ___ Expandable?	
Cooling Type- electric — Heating Type- gas | electric | oil	

Third Party Information

Appraisal(s)	
Environmental Surveys or reports	
Engineering Inspection Report	
Aerial Photos	
Site Photos	
Zoning Certification	
Economic Development Listing	

Market Information

Market Rental/Occupancy Survey	
Existing Competitive Supply Surveys	
Future Competitive Supply	
Pictures	
Feasibility Study	
Area Map	
Copies of All Building Brochures, Floor Plans	
Demographic Report: Housing, Income, Employment Three radii: 1 mile, 3 miles, 5 miles	
Traffic Study and/or Road Improvement Plans	
Traffic Counts	
Miles to nearest Interstate _____ Interstate # ___	
Miscellaneous	

I will highlight and discuss some of the more critical and important items, with the remaining items being considered as minor or just additional reference points.

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Financial Information

I will begin with the financial information, which, by necessity, is the valuation of the income stream, which is critical to the overall value and ultimately the measure of this investment. When I request information on a facility, I am usually given a pro forma statement of income and expenses.

Pro Forma literally means “to form,” but translates to “as if.” A pro forma income statement represents the income with certain assumptions that may or may not be the actual reality. **I NEED THE REALITY. In order to get the reality, I will ask the seller for:**

1. The past 3 years Operating Statements
2. The past 1 year’s Monthly Operating Statements
3. The past 3 years Tax Returns (if possible)
4. A current Monthly Rent Roll and any summary reports from their Property Management Software and or accounting program if applicable.

Again, **I’m not looking for the Pro Forma income or what the Gross Potential Income for the property may be because we only buy facilities based on their current value derived from current operating statements**. The use of the most recent actual operating income performance is a cardinal rule in valuation. **To use anything but actual performance as basis for determining income means we would be paying the seller for income that we must produce.** A pro forma income statement may represent the property as if it were fully occupied, when in reality it has more vacant units than the pro forma numbers assume or collection losses with pending evictions. If we ignore those costs and base the valuation on pro forma income, **we are in effect, paying the seller for our effort, time, and capital risk.** The ideal representation of current income is a trailing twelve-month operating statement. Just as the term implies, the statement reflects the most recent twelve months’ operations. Many owners aren’t able to generate such a statement. Most often our request for actual operating statements will garner an annual statement or the tax return for the last full year of operation, and perhaps the current year-to-date statement. If monthly statements are available to analyze turnover and cyclical expenses that would be ideal, but not essential.

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Historical Data

Historical Data for the past three years of operations is the ideal way to establish the performance trend for revenue and expenses. Three years is a good number to gain a sufficient track record for the facility, including seasonality, but may not tell the whole story. Some facilities have undergone expansion which will throw off occupancy numbers. If this is the case, I will do my best to look at the income of the property and probe more to find out how quickly the new units have been absorbed once construction was completed.

Tax Returns

Tax Returns for self storage facilities are reported on different forms depending on the ownership entity. An individual should have a Schedule E for the property, but partnerships and corporations use separate forms. Some owners will not have separate returns for each facility. They may consolidate a number of properties into one return. In this case, it would be impossible to determine the actual financial information for the subject facility.

In addition, some owners may be unwilling to simply hand over copies of their tax returns. If this is the case, I will then try to obtain their accounting reports from their CPA in addition to the internal reports from the property management software if applicable.

Leases

Leases are the most important documents that attach to an income property. Income properties are sold subject to all existing leases, unless expressly cancelled by the seller and the tenant prior to closing, **so it is critical to review EVERY lease.**

The leases should be checked against the rent roll and to verify the operating statement. In addition, **the original leases MUST be delivered to the buyer at closing.** Many courts will not allow a landlord to evict or bring action for past due rent without the original document in hand.

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Rent Rolls

Rent Rolls are a convenient report that consolidates the information contained in the leases. A basic rent roll report should show the unit number, the tenant name, the rent amount, and the lease execution date. Some reports are more detailed than others and may contain the payment history, any outstanding balance, and the lease beginning date. If past years' rent rolls are available, they can help analyze tenant turnover.

I prefer to see a Rent Roll Summary, or Rent Roll Summary Analysis that gives a more accurate snapshot of the current monthly activity.

A sample report looks like the following:

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Management Summary Report

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For Month Ending Saturday Jun 30, 2007

Alcatraz Storage at Airpark 321 W Riggin Rd Muncie, IN 47303

	Daily	Month-To-Date	Year-To-Date
From	6/30/07 0:00	6/1/07 0:00	1/1/07 0:00
To	6/30/07 23:59	6/30/07 23:59	6/30/07 23:59
Bank Deposits			
Cash	0.00	3,609.57	13,090.88
Checks	0.00	13,680.61	61,936.62
Charge	0.00	4,347.81	14,860.70
Total	0.00	21,637.99	89,888.20

Receipts

(Note: Receipts will not match deposits unless they correspond to the same periods. Deposits are based on fiscal dates. Receipts are calendar based.)

	Daily	Month-To-Date	Year-To-Date
Rent	1,027.00	20,813.42	88,936.06
Recur. Chgs	0.00	0.00	0.00
Late Fees	10.00	504.35	1,770.14
NSF Fee	0.00	0.00	25.00
Admin Fee	0.00	0.00	0.00
Reserv Fee	0.00	0.00	0.00
Insurance	0.00	0.00	0.00
Other Chgs	0.00	2.00	33.00
Misc Deposit	0.00	0.00	0.00
Overpmts	0.00	0.00	0.00
Sec Dep	0.00	0.00	150.00
POS	0.00	0.00	10.38
POS Taxes	0.00	0.00	0.62
Rent Taxes	0.00	0.00	0.00
Other Taxes	0.00	0.00	0.00
Total	1,037.00	21,319.77	90,925.20

Collections (Receipts collected in the reporting period towards rent.)

	Daily	Month-To-Date
Prepaid Rent	865.00	5,259.63
Current Rent	162.00	13,780.69
Past Due Rent	0.00	1,773.10
Total	1,027.00	20,813.42

(Receipts collected in the reporting period towards Late Fees #1, #2, #3.)

	Daily	Month-To-Date
Current Late Fee	10.00	251.85
Past Due Late Fee	0.00	252.50
Total	10.00	504.35

	Daily	Month-To-Date
NSF Checks	0	0
	0.00	0.00

Concessions (Credits applied to reporting period's charges.)

	Daily	Month-To-Date	Year-To-Date
Rent: Move-In	0.00	148.46	1,281.00
Rent: Move-Out	0.00	0.00	287.32
Rent: Other Periods	0.00	874.79	7,398.70
Late Fees:#1,#2,#3	0.00	669.00	3,149.46
Other Charges	0.00	0.00	6.67
Total Waived	0.00	1,692.25	12,123.15
Disc from Std Rent	120.00	1,935.13	7,217.94

Unit Activity

	Daily	Month-To-Date	Year-To-Date
Move-Ins	2	37	500
Insurance	0	0	0
Move-Outs	0	21	91
Transfers	0	1	12
Phone Inquiries	0	44	164
Walk-In Inquiries	0	30	123
Walk-Ins Converted	0	45	131
Letters Mailed	2	266	1586
Collection Calls Made	0	0	219
Payments Taken	18	293	
Fees Charged	0	180	
Merch. Sales	0	0	

As of Sat Jun 30, 2007

Rental Activity	Units		SqFt	
Rented Units	416	97.0%	66,461	99.0%
Vacant* Units	13	3.0%	650	1.0%
Unrentable	0	0.0%	0	0.0%
Complimentary	4		600	
Total Spaces	429	100.0%	67,111	100.0%
Waiting List	0			
Overlocked**	19			

			$/SqFt
Gross Potential Rent	26,976.00	100.0%	0.402
Gross Vacant Unit Rates	655.00	2.4%	1.008
Gross Occupied Unit Rates	26,321.00	97.6%	0.396
Actual Occupied Unit Rates	25,187.44	93.4%	0.379
Rental Rate Variance	1,133.56	4.2%	0.017
Effective Rental Rates	24,306.25	90.1%	0.366

Unpaid Charges (Curr Tenants)			Units	%GrossPot	%ofAc
0 - 10	56.80	0.5%	2	0.2%	0.2%
11 - 30	6,578.48	55.1%	44	24.4%	26.1%
31 - 60	3,309.74	27.7%	37	12.3%	13.1%
61 - 90	899.67	7.5%	8	3.3%	3.6%
91 - 120	50.00	0.4%	0	0.2%	0.2%
121 - 180	852.00	7.1%	2	3.2%	3.4%
181 - 360	203.00	1.7%	3	0.8%	0.8%
Total	11,949.69	100.0%	96	44.3%	47.5%

Delinquency (Current Tenants, 31 - 360 Days)

Units (rent only)	46	11.1% of Rented Units
Rent Charges	4,569.41	18.1% of Actual Month
Other Charges	695.00	

Liabilities	Units	$ Total
Tot Prepaid Rent	120	11,602.99
Tot Prepaid Insurance		0.00
Tot Prepaid Rec. Charge		0.00
Total Sec Dep		150.00

Rent Last Changed	Units	Var from Std Rate	Units
Leased 0 - 6 months	50	0 - 15%	46
6 - 12 months	0	15 - 30%	24
12 - 18 months	0	30 - 50%	5
18 - 24 months	0	> 50%	4
> 24 months	0	Total	79
Total	50		

Report Explanation

(*) Vacancies do not include unrentable units.
Complimentary units are counted as rented.
(**) Reported values reflect the current tenant status.
Gross Pot. Rent= sum of Std.Rental Rates as of the report date

Gross Occ Rate= gross of occupied units at the standard rates
Actual Occ Rate= sum of actual rental rates for occupied units
Effective Rate= Actual Occ Rate - Credit Concessions on rent for units occupied as of the report date.
Note: see Financial Help for analysis of Pot. vs Actual Revenue

Tot Prepaid Rent = amount prepaid as of the report end date.
Disc from Std Rent= discounts from current std (or prorated) rate

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Property Tax Bills

Property Taxes are most likely the highest expense item and should also be analyzed for a rate increase over time. The rate information is found on the source document or from the local taxing authority. Most local governments rely on property taxes as their main source of revenue, and it is very rare to hear of a tax rate being decreased. In any estimate of future expenses, I always plan for increases, especially after the sale. Some municipalities will reassess property taxes on a set time period basis, i.e. annual or every 2 years, while others will automatically reassess the property after a sale. In this case, especially with self storage facilities, I may need to plan for a significant increase in my next bill. Let's say for instance that an owner paid $120,000 for 4 acres of land 10 years ago, and the tax bill has remained at that value for the same period. However, in that time, he has added 5 self storage buildings with 223 units and has sold it to me for $1,000,000.

The value has now increased dramatically, and thus the reassessment will come in at the new value, along with a hefty new tax bill! I need to be prepared for this after closing, and adjust my valuation accordingly when preparing my financial analysis. As discussed earlier, I will also ask the owner if he or she has ever appealed the current tax assessment to gauge whether there is an opportunity post purchase to attempt, especially if it is an established and stable facility. In either case, if the owner cannot present you with the rate card or tax certificate, it takes only a few minutes to verify the information straight from the source, and if you are in the tax office personally, there is an opportunity to strike up a conversation with a clerk who may grant some insight into the local atmosphere regarding potential tax increases. I also use the opportunity to inquire as to whether the property taxes are current. **Past due taxes are an indicator of financial stress on the owner** and the taxes constitute a lien that must be satisfied on transfer, reducing cash to the seller at closing.

Insurance

Insurance policies have a wealth of information if used properly. Many owners have one carrier or agent for a number of facilities, so I will ask if the insurance cost stated on the operating statement is for the subject property. Most owners also carry a separate liability or umbrella policy that may be reflected in the cost shown. The answers to those two questions can mean an expense reduction when and if other properties are included or a source of hidden expense if the cost of an umbrella policy or general liability policy is not included. This provides an accurate basis for comparing costs when getting your own quote.

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I will also use the basic information from the existing policy to acquire my competitive bids such as the amount of loss insured, the type of policy and standards of coverage (replacement cost, business interruption, etc.), any riders attached for additional property or casualty (flood, disaster, etc.), and any exceptions to the coverage are essential in getting competitive bids.

Property insurance costs increased dramatically after the attacks on the World Trade Center and the events of September 11, 2001, but since then insurers have refined their coverage parameters, competition is once again evident, and prices have stabilized and have even declined in some cases.

When getting bids, some carriers may ask for a claim's history report or loss history report. These reports follow the property and the area and show whether there is a potential problem with this property or the area based on any payouts for flood, fire, etc. At the time of this publication, the premium for the Brownsburg Crossing Facility that I have referred to, and which is included in the case study, was $5,216 per year. A Coverage Description is as follows:

A. Buildings	$1,700,000
B. Business Personal Property	$5,000
C. Loss of Income	$ Actual Loss Sustained
D. Employee & Dishonesty	$50,000
E. Money & Securities	$5,000
F. Business Liability	
General Aggregate	$2,000,000
Products	$2,000,000
Personal & Advertising injury	$1,000,000
Each Occurrence	$1,000,000
G. Hired Auto and Non-Owned Auto liability	$1,000,000
H. Fire Damage Legal Liability	$100,000
I. Medical Payments	$10,000 each person
J. Customer's Goods legal liability	$1,000,000/occurrence
K. Sale and Disposal liability	$1,000,000 annual aggregate
L. Umbrella Liability	

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	Each Occurrence	$5,000,000
	Aggregate	$5,000,000
	Retained Limit	$10,000
M.	Deductibles	
	Deductible applicable to A, B, and C	$1,000
	Deductible applicable to D	$250
	Deductible applicable to E	$250
	Deductible applicable to K	$1,000

Utility Bills

Utility Bills are a vital part of determining the overall expense of operating the facility. It is essential to review and investigate beyond the mere amount of reported expense from the owner or broker. Annual or monthly utility costs as reflected on an operating statement are not enough to determine if the cost and usage is in line. **I strongly recommend getting copies of at least two years of the actual monthly bills, showing both the cost and usage**. It is imperative to get annual expenses, especially in areas that incur different climates and have an office on-site. If the owner does not have the past bills, it is fairly easy to request them from the utility company by providing the account numbers given by the owner. Another reason for getting 2 years' worth of bills is because many utilities are owned and operated by municipal providers. In recent years, the financial stress on local governments has increased. As a result, many municipalities have been forced to make utility operations self-sufficient. Some have gone even further, turning utility operations into a profit center to generate revenue without raising taxes. As a consequence, some areas have seen water and sewer rates triple in a five-year span, and electricity costs have increased dramatically. Although self storage facilities are not big users of water, gas, and electricity, major increases can affect the overall expense and thus the value of the property and should be closely scrutinized.

Vendor Contracts and Agreements

Vendor Contracts and Agreements connected to the operation of the property must be fully reviewed. This can range from the management agreement to the yellow page listing. **I ask for any and all contracts which may include lawn/landscape contracts, snow removal contracts, pest control services, Trash bills/contracts, janitorial supply, Truck Rental, and moving supplies vendor agreements.** All agreements should be reviewed for the ability to cancel on the sale of the property and any automatic renewal clauses. Most management contracts are drawn with the specific owner, and few survive a sale, but do not assume this is the case. I highly recommend you review the agreement to make sure of the terms of dismissal or to know the current terms if you

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plan to retain the individual managers. Likewise, with any employee agreements, be careful against inheriting any unpaid withholding taxes, raises, or labor contracts. I also recommend scrutinizing the waste disposal contract as many of these contracts automatically renew if notice of cancellation is not given within a very short window of time, sometimes ninety days prior to the expiration of the contract. If the facility has a contract with the local credit bureau for screening potential tenants, review the agreement and check for any new rate programs.

Warranties

I also ask if there are any transferable warranties for the HVAC systems of the office and/or for any climate-controlled units. In addition, I would like to see any remaining warranties on the building themselves including the roofs and doors. Any warranties still in effect should be transferred at closing.

Personal Property

Personal property must be dealt with on a case-by-case basis. It is not essential to the initial analysis, but should be discussed and agreed upon as to whether the property will transfer upon the sale. **Before closing, I plan to conduct a thorough personal property inventory for the major personal property and then I will always supply a copy to the closing agent for inclusion in the closing package**. All too often in the inspection phase, it is easy to forget to ask about extra-ordinary property that may be furnished to tenants such as shelving, or dollies, and the small tools, supplies, and equipment used in the day-to-day operations. If the owner has personal property on the premises, it should not be assumed that it transfers as well. As a practical matter, I need to know what equipment and supplies will be on hand upon closing. **I will fill out the personal property addendum, a sample of which is included in the Appendix and on the forms CD, listing each computer, monitor, desk, chair, dolly, etc. on a separate line including description or serial number, and have the seller sign this a week or two before closing so that there are no surprises when I show up at the facility the day after closing.** In addition, I will ask them to include all operating manuals for the computer, software, gate equipment, and any other office equipment.

Survey

The survey is also one of the most important documents to review before purchasing a self storage facility. Most sellers will have some sort of survey, but it may not be sufficient for purposes of satisfying our lenders. Most lenders require an American Land Title Association (ALTA) standard survey, which developed comprehensive

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minimum standards in 1999 for the completion of commercial real estate surveys. The ALTA survey requires the surveyor and the title company to work together in determining that the property's actual physical presence and its legal description match. A current title commitment is required before an ALTA survey can commence. The surveyor will refer to the title commitment for the legal description of the property and for the legal description of any encumbrances (exceptions) on title. Areas of ownership, improvements, easements, rights-of-way, and encumbrances are shown graphically. If the surveyor discovers any encroachments, they are also shown graphically with a note indicating the nature of the encroachment. An encroachment is any improvement or feature on one property that overlaps onto another property. So, an encroachment works both ways, from adjacent properties into the subject property and vice versa. An encroachment is an invitation for a future dispute between property owners and must be cured if possible before taking title. It may be necessary to have adjacent property owners execute affidavits confirming an existing encroachment, perhaps to the extent of extinguishing any right to revisit. The surveyor will then provide the title company with the information to ensure the title to the land and improvements match to the degree required. The surveyor and the title company rely on each other's work to comprehensively show the matters affecting the ownership.

Who pays for the survey is negotiable, sometimes determined by the local customs in your market, but as stated earlier, **I always draw up my contracts stating that the seller is to pay?** That being said, the ALTA survey is much more expensive than a standard mete and bounds survey, approximately $3,000 for a typical 4-acre facility, and if the seller balks, I will be forced to pay for it. Whether or not an ALTA survey is required by the lender and regardless of who has to pay for it, I always obtain a detailed and accurate survey of the property, and strongly recommend you do the same.

Existing Site Plans

It's always good to have any existing architectural plans, engineering plans, or utility plans in the seller's possession. This can be helpful and possibly save you money in the future should you decide to construct additional buildings on the site. At the very least, the seller should sketch out the location of water meters, water and sewer mains, and as many of the utilities as can be located.

Business License

The business or retail license should be on the property, on the wall, or in the owner's files. If the locality does not require a business license, this should be verified with the local government. In addition, if the facility sells locks, boxes, and other moving

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supplies, most municipalities will require a retail sales license, and subsequently are required to pay retail taxes. I will always ask the seller how they have handled the retail portion of their business and then I will verify these requirements with the local government as well.

Zoning

The zoning certification must be obtained from the municipal jurisdiction, usually at the local Planning or Zoning office or perhaps in Economic Development office. The current zoning compliance can usually be verified with a phone call to the appropriate office, and is essential to move forward. I do not accept anyone's statement about zoning compliance; **I will always obtain the official zoning letter prior to closing, and make it a requirement of accepting the due diligence package.** Should you discover that the zoning does not support self storage after you close, you open yourself up to a huge expense of re-zoning, and if it were to be turned down, then you run the risk of losing the entire basis of your investment!

Appraisal

The seller may have an existing appraisal and be willing to share it, but is fairly unlikely. Sellers are reluctant to show you an appraisal with a value below your current negotiated purchase price. In most cases the property or the market will have changed since the old appraisal anyway, and the value may not be relevant. Appraisals are very time-sensitive and their use and reliability is restricted to the original parties who requested the report. In addition, often times, a value for a refinance with the existing owner vastly differs from the value given if the facility is being sold.

If you do get a copy of an old appraisal, it can be of some help in gathering market data and understanding the competition surrounding the facility. My lenders will almost always want to order a new appraisal, but some costs may be saved if the existing appraisal is less than two years old, and the property hasn't undergone any major changes. Most lenders have a short list of appraisers that are approved by the bank, and every so often the old appraisal had been written by the same appraiser they have commissioned, and may be updated at a lower cost. However, this is the exception, not the norm.

If a new appraisal is required, I always try to accompany the appraiser on the site visit. I always pick up a great deal of information about the facility, and I can also show him why I think it's a good deal and thus, should come in at our negotiated selling price. I also take this time to ask the appraiser about the local market, recent transactions and any other questions that may arise as a result of our time together. **Appraisers have a good**

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handle on the market, and often times can be a good source of leads, so I always ask if he or she knows of anyone else in the market that may be interested in selling.

Phase I Environmental Report

As we touched on earlier, the Phase I Environmental Report has become the standard for almost any loan from any source. A Phase I Environmental Report is an inquiry conducted to determine the environmental status of a facility in connection with the sale of a property. It follows testing standards that include those published by the American Society for Testing and Materials (ASTM; www.astm.org). The Phase I report includes a review of public records and databases maintained by each state and the federal government for environmental "events" or known contaminations on the property or in the immediate vicinity; interviews with all owners available in the chain of title for a specified number of years; and a visual inspection of the property. Included in the review is a LUST (Leaking Underground Storage Tank) survey for the site and the area within a one-to-three-mile radius to determine if there is any downstream risk to the site from known hazards. A Phase I report does not include any testing or sampling of the ground or ground water. Based on the findings from the review of public records, a conclusion will be offered as to whether or not any further action is recommended. If no further action is called for, the site is referred to as "clean, "the report is delivered to the owner and lender, and the file is closed.

Phase II Environmental Report

If the Phase I report does recommend further action, there will be a recommendation as to what type of action is warranted. For a site with only suspected contamination, a Phase II Environmental testing may be sufficient. A Phase II report is called for when the site has had some prior use that raises the possibility of contamination, even though there is no reported or visible contamination. The project will include several shallow soil samplings and testing of the samples for contaminated material. Groundwater sampling may be included in areas of high run-off or flowing streams. The report will then conclude whether further action is necessary.

Phase III Environmental Report

A site with confirmed contamination from a prior user, the results of a Phase II project, or visible evidence of environmental risk will require a Phase III Environmental Report. These projects include a full range of sampling and tests, such as core drilling, ground penetrating radar, and asbestos and lead sampling. The objective is to establish not only the degree of contaminants both onsite and offsite. If the source of the

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contamination no longer exists, the engineer will recommend a course of remediation in accordance with state and federal regulatory and statutory requirements. Appropriate measures for the removal of contaminated materials range from excavation and replacement of the soil to capping the area and leaving it alone. Remediation may include the placement of monitoring wells on the site at the owner's expense with testing performed over a number of years before the file can be closed.

In most cases, the presence of environmental problems doesn't mean I won't do the deal. You have to weigh the cost of remediation, and determine if there are any potential liability issues. However, in the case of self storage, you are not as exposed to people coming in contact with any potentially harmful contaminants like they would if you were looking at an apartment complex. Each situation is different, so **I recommend that you consult your attorney, appraiser, lender, and your inner circle of friends in the commercial real estate industry to assist you in making the decision whether to buy a facility that possesses environmental problems.**

Building Inspection

The Building/Engineering report is the commercial property equivalent of the home inspection for single-family homes. If you are dealing with a national lender or conduit loan, this is most likely going to be required for the lender's underwriting process and disclosed at the time of application. The inspection itself for a self storage facility is not that extensive, but could be costly if the inspection firm selected is some distance away. I always ask my lender for a list of approved firms and select one local to the facility in question.

The inspector will test the property's systems, evaluate the structural components and note any deferred maintenance or deficiencies. The property's compliance with building codes and legislative requirements for the property type will be noted in the report. For multiple story facilities, if the building has an elevator, either freight or passenger, there are regulations which may require an Elevator Inspection Report. At the very least, I always ask for the most recent inspection for review. The inspection in many deals is optional; however, **I highly recommend you have an inspection performed on every property you purchase.**

HVAC systems

HVAC systems for the office or for climate-controlled units should be inspected for clean filters, operation, and clear ductwork. This would typically be included in a building

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inspection report, but if the lender does not require the inspection, I always make sure the HVAC systems are thoroughly tested.

Site and Aerial Photos

Some national lenders may request aerial photos of the facility. If the present owner has an aerial photo, ask him to email or give you a digital copy of the image if possible. If not, you can scan the existing photo and forward to the lender. Be sure to keep a copy to use in future marketing materials for the facility. If the seller doesn't have an aerial photograph, you can find a company to take one by simply looking in the Yellow Pages, or calling the local airports and asking around. Likewise, property photos are necessary for the business plan, loan request, and insurance request package. The photos may be coordinated with a neighborhood map showing shopping, schools, and main traffic arteries for a complete graphic package. This can give a loan reviewer a good idea of the condition and general feel of the property.

Decision time

When the due diligence is complete, I have a decision to make. My contract states that at the end of the inspection period, I must accept the property and allow the earnest money deposit to go at risk, or not accept the property and have the deposit returned in full. My investigations may reveal conditions that differ from the seller's representations or render the property undesirable. Such derogatory conditions may warrant an adjustment in the price or terms of the sale. This is up to me of course, and may cause further negotiation with the seller dependent upon the findings of my inspections, and the amount of money required to rectify any previously unforeseen problems.

In some instances, the seller has just plain lied about the property, its income and expenses, or conditions. If this is the case, he probably has told other lies, and it's time to move on. Unfortunately, some minor non-disclosure is all part of the game, but major misrepresentation is just not acceptable, and it may be better to walk away than to proceed with no idea what surprises may be lurking.

More routine discrepancies are due to differences in bookkeeping or definition of expense items, the integrity of the rent roll, or physical problems with the structural or environmental aspects of the property. In these cases, I must consider the costs of fixing the problems, and **in no case would I accept a reduction in income without adjusting the terms of the deal to compensate for the loss in value.**

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Summary

Due diligence is the chance to investigate a facility before writing the big check. If we take advantage of this opportunity, we eliminate most of the risk that stems from lack of knowledge. Craft the terms to allow plenty of time for the due diligence inspections, and then control the entire process from beginning to end. Remember that due diligence starts with the first contact and continues all the way to closing. If the seller understands that you are going to be thorough and methodical in investigating the property, he will be less surprised and upset when the questions start hitting close to home. Remember, this is the only opportunity we have to get the information while the seller wants to help. After the closing, the same seller may not return your calls, but before the money and the property changes hands, you have some leverage.

If you take the team approach to due diligence and hire industry professionals to help you inspect the property, I urge you to make sure that the assignments and responsibilities are clearly defined. I make sure that I "baby sit" each lawyer, surveyor, inspector, appraiser, and environmental engineer to be sure each is aware of the timetable in which I must have their completed reports. If necessary, I will call weekly, or every other day to be sure that they are kept on task since it only takes one missing document to delay a closing.

There is no substitute for thorough due diligence, but it can be a double-edged sword. I've never seen a property without some hidden defects, and in most cases I have not found them until after I own it. The benefit of being thorough in your due diligence is that it gives you the confidence to act decisively and with assurance that you have eliminated any potentially major problems.

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CHAPTER 11

Valuation

Scott Meyers

The key to success in buying and selling self storage facilities, or any type of commercial real estate, is a thorough and comprehensive understanding of value. Proper valuation is the basis for all investment decisions, whether it is an investment in stocks and bonds of various companies, precious metals, or real estate. It is an absolute must that an investor understands how value is derived in order to make prudent investment decisions. There are a number of ways to determine the value of a self storage facility and therefore a considerable amount of debate as to which approach is best. I'll discuss the three most common methods used in the market and allow you to make your own decision based on the approach you feel most comfortable with.

Appraised Value

Throughout this discussion, I will be referring to appraisal practices as recommended by the Appraisal Institute, an international membership association of professional real estate appraisers, with more than 18,000 members and 99 chapters throughout the United States, Canada, and abroad. The MAI membership designation is held by appraisers who are experienced in the valuation and evaluation of commercial, industrial, residential and other types of properties, and who advise clients on real estate investment decisions. The MAI designation, which means "Member, Appraisal Institute," is the highest level of accreditation of AI, and the accepted standard of professional accreditation in the commercial real estate industry. Most lenders will require an appraisal from a MAI appraiser that the bank has previously approved, and I utilize a MAI appraiser in all my transactions, whether the bank requires it or not, as a matter of principle.

There are 3 ways of determining appraised value which include comparable sales, replacement cost, and the income approach. The appraiser typically evaluates the property from each approach and then determines final value based on a weighted

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average of the three. The final value determination is the reconciliation of value which reflects the combined factors of property condition, market, and sale terms.

Comparable Sales

The most familiar of the three appraisal components is the comparable sales approach. This approach is often the best indicator of value used in single-family real estate. The appraiser will collect sales data from recent transactions within a specified radius, typically the same neighborhood, and adjusts the data for location, size, quality, and other factors for an accurate comparison to the subject property. Unlike residential appraisals, self storage facility sale comparable are not required to be within proximity to the subject. Some facilities are so rarely sold in a given market that the appraiser must cast a much wider net than the immediate market for a contemporaneous comparison. Property type, market, and conditions are more important, and the comparable may be in another city or sometimes another state. Appraisers maintain extensive databases that archive not only the assignments they personally complete, but also those transactions completed by others. While sale prices are public record in most states, the transaction terms are not available to the public, and often times not to the appraiser. Sale terms, facility condition, or an arm's length transaction can greatly influence the price reported. By sharing this information, appraisers can gain a better understanding of the market at large. By using data from a pool of transactions, the appraiser can render a more accurate and objective comparison. Once the comparable sales are identified, they are adjusted for age, construction type, location, size, condition, and amenities to provide a meaningful comparison to the subject property. The appraiser reduces the data to a per-square foot or per-unit measure, which is then applied to the subject property to reach one estimate of value. Because the MAI methodology recognizes the variable nature of self-storage facilities, the comparable sales approach is not used as the sole input to the determination of value.

Replacement Cost

To determine the replacement cost of a self storage facility, it is necessary to first deconstruct the components of the facility, assign each component a current value, then adjust for age and condition. In essence, the appraiser performs a build out analysis for the facility as if it were new construction, adjusted for the depreciated value of the improvements.

Starting with the raw land value, the appraiser will establish a "land as vacant" value, utilizing comparable sales methodology from recent land sales in the immediate area. They will take care when accounting for zoning, location in relation to various

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demand generators, traffic counts, access, and visibility. The comparable are adjusted upwards or downwards for these factors in relation to the subject property in order to establish the market value of the subject property on a per-acre or per-square-foot basis. A highest and best use analysis will also be performed for the site. It is at this point in the valuation process that one must ask the question, “if we had the opportunity to replace this property as it exists today, would that in fact be the best use of the property?”

The appraiser then turns to establishing the cost of the building and improvements (buildings, paving, office, fencing, landscaping, gate, security, lighting, HVAC, etc.). There are a number of service companies that compile and distribute self storage building costs nationwide who supply appraisers with current construction cost data for a wide variety of building types. With this data, the appraiser inputs the particulars of the facility and establishes the cost to construct the existing improvements as if they were new. Once the improvement cost is established, the value must be adjusted for age and condition, as well as any obsolescence in design or construction. Building life, rather than standard tax depreciation schedules, is used to make the adjustments, and the final estimate of the adjusted cost of improvements is then added to the as-vacant land value for the total cost valuation of the facility.

In my experience, the replacement cost approach has proven to be the least relevant value of all. Most facilities use very similar styles of metal building construction, and were built within roughly the same time period (within the last 15 years). In some rare cases, you’ll run across some cement block facilities, or some asphalt shingle roofs, and there will be an adjustment for those items. But by and large, the values for replacing the facilities you will encounter will be very similar.

Income approach

For self storage facilities, which are classified as income producing properties, the income approach is typically given the most weight in the final value reconciliation by appraisers.

By definition it requires accurate input of the operational data from the property and the market.

There are actually three methods by which the income valuation may be performed. Direct capitalization, yield capitalization and the Band of Investment are the accepted methods of calculating value via the income approach. The method chosen by the appraiser will be determined by the nature and scope of the appraisal assignment and the amount and detail of data available regarding comparable facilities.

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The Band of Investment method, also known as the Ellwood Formulation, is appropriate for income properties where there is an ample database of market data that backs up the assumptions needed for calculations. This calculation considers loan rates available in the market; required returns on equity; the income produced from the property over an assumed holding period; and the reversion (sale) value at the end of the holding period. It is similar to the calculation of the Internal Rate of Return (IRR) discussed later in this chapter, but rather than solve the equation for the potential rate of return, the Band of Investment calculation solves for initial value, also known as net present value.

Critical assumptions in the calculation are: the investor rate of return on equity capital; the finance terms of debt capital; the lease rate from the facility; the expenses and the amount of increase over the holding period; and the sales price cap rate.

Reconciliation of Value

The conclusion of the appraisal report is the Reconciliation of Value, and explains the appraiser's rationale and support for weighting the three value conclusions. After weighting the three approaches, a final opinion of value will be rendered. This is most commonly defined as an estimated market value. Market Value is defined as the price at which a property will sell after a reasonable time of exposure to the market, from a willing seller and willing buyer, in an arms-length transaction, with no duress or special conditions of the sale.

Most people never read the entire appraisal report. Most of us look at the first page to see the value of the facility and close the report, and I'll admit, I have been guilty of this as well. **However, I highly recommend that when you are given an appraisal, you read more than the executive summary**. At a minimum, review the income approach section and note the assumptions of income, expense, equity return and loan terms. Analyze how these assumptions add up against the current leases, building age, condition, operating expenses, and most importantly, your loan and preferred return requirements. Do not be surprised to find a wide variation between what is assumed by the appraiser in the report and what you have found during your due diligence. **I also pay close attention to the comparable to see how my per unit purchase price stacks up against other facilities in the market that have sold recently.**

Intrinsic Value – What's it worth to me!

What truly matters most in determining the value of a property can be summed up in one simple question; *"what is this facility worth to <u>me</u> today, in light of all known and*

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unknown conditions?" At the end of the day, I look to the income produced by the investment as the return on my capital and compensation for the risk and effort I will put forth on this endeavor. And as I have stated several times before, the income stream is what I value most.

As the source of my compensation, the **Net Operating Income becomes my primary basis for the determination of value**. If I'm going to use the NOI as the basis of value, then I must be certain that the NOI calculation is accurate, and if not, then neither is the valuation I derive from it.

In the course of my due diligence, I spend considerable effort to verify the line items of income and expense from the property operating statement. Then **I will adjust the statement for any differences between the current owner's management structure and practices, while taking into consideration the manner in which I will run the property after acquiring it. This new statement will provide a baseline for an operating projection that predicts how the facility will perform under my ownership.**

Income

Self Storage facilities often have more than one source of income, and to accurately value the income stream, I will classify the income by source. For instance, a facility may have a retail component that sells locks, boxes, and other moving supplies. Some owners will broker renter's insurance, and others are in the truck rental business either through a 3rd party vendor or by renting their own company trucks. Some facilities may also offer a pack-ship service or an eBay® sales outlet. Once I have broken out the various income sources and determined whether I plan to continue with any or all of these income streams, I will now have a clear picture of the potential income of the facility when it's under my management.

Once the ancillary and variable income has been classified, and either eliminated or included, then my real work begins. The objective is to determine as accurately as possible the current and collectible income. The income is verified against the current rent roll, and any doubtful income must be excluded. **Any account more than sixty days past due is considered a doubtful account, and virtually uncollectible**. If there are numerous non-performing accounts, by all rights they should be excluded from the current income calculation. There comes a time when a judgment call must be made as to the inclusion of doubtful tenants. A facility with high turnover, collection issues, and numerous auctions, carries with it the requirement for increased risk and effort for the steady continuance of income. This is generally reflected in the valuation by increasing my rate of return.

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Once we are confident that we have the correct income figures based on the current rent roll, the next step is the normalization of the expenses.

Expenses

On the expense side, normal due diligence includes verifying the contracts with 3rd party vendors and as many of the expenses as feasible. In addition, I always evaluate the expenses on an annual basis due to the cyclical nature of some payments and to account for seasonal variations of others.

I review the operating expenses for any anomalies that may exist under the present management that would not be included in the normal operation of the property or would be present once I began managing it. Some owners take a management fee that may or may not be in line with the market, or what may actually be required for this particular facility. Some maintenance expenses may not include labor charges and items such as office expense, professional fees or auto expense may be charged to the property to accommodate an owner's preference in bookkeeping, but are not specific to the day to day operations of the facility.

It is also common to see an operating statement with just a few line items of expenses for the bare minimum of property tax, insurance, utilities, and maintenance. **During my due diligence, I ask a lot of questions in order to expand the line items and identify as many of the expenses as possible**. Maintenance can be divided into parts and labor, and advertising may be lumped into a miscellaneous expense category. And as a general rule, utility expenses should be separated by each service; gas, electric, and water so that I can verify the annual expense, and cyclical or seasonal nature of each.

Self storage facility owners will sometimes lump expenses from several properties on one operating statement or tax return. All such items should be deleted, and I will ask the owner to provide the expense item in each category that is specific to the subject property. More often however, the owner will understate the expenses with the most common place being in the maintenance category. Although self storage facilities are generally low maintenance, there are springs that break, doors and gutters that get damaged, parking lots that need patched and resealed, and gates that need repaired in addition to routine paint and other miscellaneous maintenance that needs to be performed. I always check the annual per-unit maintenance cost to see if it seems reasonable given the property rent roll and turnover rate and compare that to my own internal numbers derived from my existing portfolio and industry standards.

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Remember that deduction of the actual expenses assigned to the property from the true income of the property establishes the normalized NOI, which I use in all calculations going forward, so **it is imperative that it be as accurate as possible.**
With an accurate representation of the current normalized operating performance, I can now move to the next step in determining intrinsic value.

What's it worth to me?

Again, the real question in valuation is not how much another investor or an appraiser thinks a property is worth, or the value from a cap rate estimated in the market, but rather the value at which I can attain my investment goals, and is also reflective of my power to borrow money for this investment. I've defined that as the intrinsic value of the facility, which simply put is what the facility is worth to me, regardless of anyone else.

Intrinsic value has two components, the return of my capital and the rate and terms of the debt I will be placing on the facility. Unless I am buying the property with all cash, my return is affected by the finance terms from my lender at current market rates. This allows me to pay more for a facility and still reach my desired rate of return for this property. I pay close attention to cap rate, and typically, it is not as sensitive to a change in equity return as the percentage rate of the loan. This is due to the overall weighting of the loan in the transaction. Since the loan comprises the majority of the investment, changing the terms produces a greater variation in the end result. This emphasizes how important it is to negotiate for every last percentage reduction in interest rate possible when working with lenders and structuring your deals.

Valuation Summary

As you can see, there are multiple ways to value a self storage facility, and using only one method is not what I would recommend for producing the best results. Learning how and when to use a combination of these formulas and incorporating your desired rate of return will aid in making a less risky purchasing decision. As you have seen, all these factors interact to form a subjective value estimate specific to the conditions in existence of the investor performing the valuation. That means that "value" is highly subjective from one investor to the next, and depends heavily on the risk tolerance, management style, and financial wherewithal of each investor. It is possible that ten investors could look at the same information for the same facility and each reach a different estimate of value, and all of them would be considered correct for their individual circumstances. Once you incorporate the concept of establishing your individual value, you will understand that just because another investor is willing to pay more for a property than you, it does not mean that your calculations are incorrect.

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As stated before, **I am primarily cap rate driven, and look for investments that are priced at a true 10% cap rate or higher, based on ACTUAL income and expenses given the interest rates at the time of this publication (6%-8%).** This figure will vary slightly given interest rates and a few of the factors we have mentioned depending upon my individual situation at the time.

The thorough analysis of prospective acquisitions by dissecting the financials is essential in establishing value. It removes the emotion from the equation and gives us facts with which we can make more informed decisions.

Self Storage Valuator Software

To make this easier, I have included the **Self Storage Valuator Software** tool in this home study system which is designed to enable you to analyze your deals with amazing speed and accuracy. It allows you to quickly generate unique insights into each facility and give you the confidence you need before deciding to move forward with any acquisition. A detailed step by step manual will guide you through each the program along with my unique insights and methodology behind each entry and calculation. The Self Storage Valuator™ software tool provides concise information and the professional format necessary for getting your deals approved through potential investors, banks, and appraisers alike.

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CHAPTER 12

Financing Your Facility

Scott Meyers

Most types of investments won't allow the use of high leverage using the securities themselves as collateral. This makes real estate investing somewhat unique in its use of financing. **The use of leverage in real estate investments is a proven method to accelerate returns and create wealth**. But one must be careful not to over-leverage. As we examine the various types and sources of financing available for self storage facilities, I will also point out the dangers that can result from over-leverage and pitfalls of various financing structures.

There is a wide array of financing vehicles available from an assortment of institutions and intermediaries. What was once a short order menu in the financing arena is now a smorgasbord of products that can be mixed and matched to accommodate almost any project. There are trillions of dollars in real estate mortgages issued each year in the United States alone. It has been estimated by the US Congressional Budget Office that approximately 76% of the nation's wealth is in some form of real estate ownership or securities backed by real estate. That dwarfs the investment in all other industry sectors combined.

In the past twenty-five years, the financial industry has rolled out a myriad of mortgage products designed to make real estate ownership available to all segments of the population.

As with residential financing, banks are no longer the sole source for commercial real estate loans. In the early 1990's, securitized financing was also developed for commercial real estate from lenders known as conduit loans, because they channel money to borrowers by selling securities backed by large pools of mortgages to investors seeking stable returns. Insurance companies, formerly the first choice for long-term mortgages on large self storage facilities because of their low loan costs, lost significant market share and are now scrambling to compete. As a result, banks have become extremely aggressive in finding niches to lend on properties too small or too risky for the conduit and

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institutional lenders. The benefit to this new financial market is that like home ownership, commercial real estate is now within reach of almost any investor.

Funding Sources

Not all lenders or all loans will fit all self storage facilities or deal structure. I'll begin by discussing lenders that are available for the largest loan amounts, which will typically be our first mortgage. We will then discuss the various ways to find the cash for our down payment, or the equity portion of our investment.

Seller Financing

A common and often times preferred source for financing self storage facilities is some form of seller-held financing. There are many advantages to using seller financing to fund a portion or perhaps 100% of your investment. Typically, this includes no points, no fees, no appraisal, no survey, and no need to educate the lender about the facility. In addition, I can negotiate directly with the seller (financier) to structure a loan that is attractive enough to convince them to hold some or all of the financing. **The most common use of this technique, and one I try to utilize on each and every one of my deals, is to get the seller to hold back a second mortgage to fill the gap between the sales price and the first lien being provided by the lender**.

Seller financing can be either short or long term, interest only or amortizing, with or without a balloon. In many cases, seller carry backs can be sold on the private market to create cash at closing to the seller if the structure and terms of the note are marketable with standard commercial terms.

Private Lenders

Wealthy individuals, or what many in the industry call "Country Club Money" are often used as sources of financing, but can be hard to come by. Low interest rates as of late have caused many wealthy individuals to consider lending money for real estate simply because the returns are much higher than CDs or bonds and the debt is secured by a tangible asset, the facility. The total loan amount will vary based upon the individual and his or her wherewithal. Typically, interest rates can range from 6% to 20% depending on the deal, current market rates, timeframe, risk, amount, etc. There is no governmental or regulatory oversight of private lending so rates and terms are negotiable between the parties involved in the transaction. As with seller financing, the terms are generally more flexible than other lending sources and may not require extensive third-party documentation and fees, and are relatively quick to close. Most private lenders

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prefer a short time frame to be paid back, typically one to three years, with the loan being amortized or interest-only with provisions for rate adjustments if interest rates begin to rise.

Mortgage Brokers

A good mortgage broker is an invaluable resource for the real estate investor. An established broker will have a long list of preferred lenders and knowledge of which lender matches best with your project, and will package the loan proposal in a format that allows multiple submissions to several lenders. One advantage of working with a mortgage broker is the ability to shop one lender against another, resulting in better terms or better pricing.

Fees to the broker will typically range from one-half to two points, though higher fees are charged for difficult projects or complex deal structures. Brokers structure their fees based on the wholesale cost of the loan quoted by the lender. In some cases, the lender may price a certain type of loan at a 6% rate with zero points in origination fees. The broker would then price the loan to you at a 6% rate with one point in origination fees. Other times the broker may add on a premium on the rate, perhaps quoting a 6.25% rate and receiving extra compensation from the lender over the life of the loan. This practice was at one time very common, but competition has made it the exception to the rule.

Application fees are typically a few hundred dollars for credit checks and advance payment for third party reports such as the appraisal and survey and are normal and ordinary expenses that are expected. However, these fees should be disclosed in writing in the initial application letter.

Note that there is a difference between an advance deposit for third-party reports and a deposit. Third-party fees include the appraisal, survey, environmental reports, and engineering inspections, and often times require payment before ordered. However, I always ask if these reports and vendors can wait to be paid at closing and out of loan proceeds if possible.

Mortgage Bankers

Mortgage Bankers will be mentioned frequently throughout this home study course as this is my preferred funding source. It is important though to remember that a mortgage banker is not synonymous with a mortgage broker. The simplest way to describe the difference is that a mortgage broker works with multiple banks, and the mortgage banker works solely for the bank in which they are employed. The benefit to a mortgage banker is that they typically possess years of experience and education required to represent a

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firm as a mortgage banker. In comparison, a mortgage broker can get started with no experience whatsoever.

The mortgage banker may have outside relationships with additional sources of funds such as life insurance companies, pension funds, and private investors, and may bring them in to participate on a loan to complete the deal, but this is the exception not the norm.

In practice, both the mortgage banker and the broker fill the same role to the borrower. They specialize in mortgages and only mortgages. The mortgage banker has a small advantage in being able to warehouse a loan, meaning they can close the loan by advancing the banks own funds, and wait for the security of the facility until a later date. This can make all the difference in funding a particular loan for your time sensitive deals.

Hard Money Lenders

An alternative source for short-term funds is a group known in the industry as hard money lenders. The term is derived from their terms, which can be described at times as hard to swallow. They specialize in funding hard to finance deals and borrowers. A typical hard money lender will loan at a lower loan to value ratio (LTV), typically no more than 50% to 65% of the deal, and charge anywhere from three to twelve points in upfront fees and require a first lien on the property. Payments are generally interest-only at rates well above market, with a term of only one to three years depending on the nature of the deal and the plan for the property. Default penalties are generally more severe as well, sometimes adding as much as 20% or more in collection fees on the loan balance should the loan go into default.

The criteria for a hard money loan can be understood as follows: The lender makes the loan on such terms that it will make even more money if the borrower does not pay, and the added benefit of possibly getting the facility in the case of default. The default and collection fees are designed to guarantee that virtually no money is returned to the borrower if the property does happen to bring market value in the event of a foreclosure sale.

To summarize, it’s almost always a win, win, win for the hard money lender. There may be times when a deal is so good that it warrants bringing in a hard money lender, but **I will caution you to explore other options such as a partner or perhaps a family member to invest with rather than using a hard money lender**.

Commercial Banks

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There are three major types of commercial banks: A. Megabanks, B. Large regional banks, and C. Small independent banks.
The differences are based in their institutional focus and can be significant for the self storage facility borrower. All types listed below will entertain loan amounts from small to large, though the terms may not always suit the project. Each type offers something the other doesn't. I'll provide a quick synopsis of each.

National Mega-banks

National Mega-banks with their brand names, multi-billions of dollars in lending assets, and hundreds of locations typically will try to be all things to all people. They advertise their size as evidence that they can provide everything you desire in both personal and business banking. They possess a large organizational structure which is typically headed by an advisory board of local community leaders. Most officers within the bank have little real authority to approve loan requests, or much else for that matter. The bulk of the decisions are made by committees whose purpose is to ensure that nothing out of the ordinary occurs.

They talk a big game when it comes to their commercial lending prowess, but most underwriting is done in a different city by individuals who have no knowledge of the market or a personal relationship with the borrower, and will never set foot on the facility site. The underwriting process is akin to, and sometimes as enjoyable as performing a thorough physical, with the sole purpose of trying to reduce risk using ultra-conservative underwriting practices.

That being said, the mega-banks do fill an important role in self storage financing. Some of the best lenders and programs are subsidiaries of mega-banks. If you can find a local contact that is familiar with doing deals on facilities in your market, you may be pleasantly surprised at what they can offer you in terms of loan products, especially for the larger deals from $5 million and up.

Regional Banks

Regional banks are generally more consumer focused. They typically have several branches across a state or region and target the retail customer in their marketing campaigns. They may promote free checking, home equity loans, car loans, or other amenities pertaining to hours and ATM's. In some instances, this type of bank may be a commercial real estate lending source, but only if they happen to have a senior officer with commercial lending experience. Most have grown by buying smaller banks or

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merging and then centralizing their back-office functions to achieve economies of scale. They typically offer cookie cutter products with a regional flare, attempting to beat the mega-banks at their own game by promoting their small-town focus.

Like Mega-banks, the regional banks also operate by committee, and offer very little in good old-fashioned relationship lending with their borrowers. And in today's market, they are very apt to be bought by a larger institution and be susceptible to having their commercial program dismantled if it doesn't fit with the new company's focus.

Even with their drawbacks, their size and focus can be used in a way that few other financial institutions offer. Since they have so many small-town branches that were formerly community banks, they have some of the best people in the business when it comes to knowing the details about the communities they serve. If you develop a relationship with the central bank in the area, they can be a great resource when borrowing on facilities in outlying markets. **Few banks have their finger on the pulse of economic development and the dynamics of each community better than regional bankers**.

Community Banks

These are my favorite and the type of bank I have used for all of my commercial deals to date. Some Community banks can be quite large, with up to $1 billion in assets, but typically, the average size will be in the $250 million to $500 million range. These banks have grown up in the communities they serve and may have acquired smaller banks over the years in adjacent areas under some type of holding company structure. Some of these banks are publicly traded with their organizational structure headed by a board of directors made up of local community business owners, including real estate developers or brokers, local CEOs, and maybe a college president. Most of the board members are also large stockholders in the bank as well as some of the officers. These are real boards that make real lending decisions.

Generally speaking, daily operations are supervised by an executive committee appointed by the board. This core group of senior management will have collective authority to approve loans of $1 million or more, often times, without approval of the board. Their management style is lean and nimble, mostly devoid of all the unnecessary bureaucracy you will find in the previously discussed larger banks. These banks are designed to perform and they understand commercial real estate and actively seek out individuals who generate these deals for them. They can find a way to structure just about any type of deal, and specialize in customizing the loan to the deal since they plan to keep it in their portfolio and service it for the life of the loan. **Once you have proven yourself to**

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these banks, you will have access to some of the most flexible financing available anywhere.

Credit Companies

Credit companies are large lenders who specialize in mostly short-term finance instruments that include factoring, leasing, and real estate loans. In recent years, they have begun underwriting conduit loans and have become a major player in this market. Because of their focus on all types of business lending, they are an excellent resource of real estate financing with specialized terms for hard to finance property types, construction, turnaround projects, bridge loans, mezzanine funding, participation loans, and mini to permanent loans. They typically lend through a network of brokers, and their underwriting is specific to the requirements for the borrower and the property. In general, they offer both recourse and non-recourse financing, and rates and fees are competitive with the market at large.

Conduit Loans

Conduit is a catch-all term for a host of lenders that are connected in some way to the securities markets. The foundation of the business is based on bundling a number of loans that are similar in nature and market them as Commercial Mortgage Backed Securities. This is a relatively new area of finance that began around 1990 in the commercial finance market and its steady growth has had a dramatic impact on loan pricing and terms throughout the entire industry. These loans are typically originated through the mortgage broker's network, but are ultimately funded by Wall Street firms like Morgan Stanley, Goldman Sachs, Lehman Brothers, and others who sell the Commercial Backed Securities in the capital markets.

These loans are strictly underwritten to conform to the parameters of a particular property type. Few if any of the terms are negotiable, and most have a maximum LTV of 75%. These loans require standardized third-party reports and inspections and require the funds for those reports up front. They also require monthly escrows of property tax and insurance costs. If a significant amount of deferred maintenance exists, a portion of the loan proceeds will be escrowed to complete the necessary repairs, in addition to a monthly capital improvement escrow dependent upon condition and type of property.

The advantages of conduit loans are low fixed rates, favorable appraisal valuations, and non-recourse terms. Conduit loans are a great cash-out refinance instrument for a property that an investor intends to hold for some time. It can also be attractive for a short-term exit strategy. Since the loans are assumable, the loan may enhance the

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marketability of the property. Generally speaking, **conduit loans work best for stable and mature properties that are in high demand, such as self storage**.

The downside to conduits is that the initial expense can be very costly compared to bank loans and credit companies. In addition, the ongoing monthly escrows reduce cash flow. Prepayment penalties can easily run to several hundred thousand dollars which hampers flexibility. Also, the restriction against secondary financing essentially locks up the property's equity for the entire term of the loan which makes these loans inappropriate for properties that need a great deal of work such as turnarounds, repositioning projects, 1031 exchanges or other creative deal structures.

Savings and Loans

Savings and Loans (S & Ls) are an all-but forgotten source of funding for commercial real estate. The S & L industry almost faced extinction due to shortsighted acts of Congress in 1986, and many of these institutions spent years fighting for survival. Much of their market share has been taken by the conduits and commercial banks, but not in all areas. Under current government regulations, Savings & Loans can securitize their loans for sale in the secondary market and use excess cash to buy mortgage-backed securities. This has loosened their reliance on deposits to fund loans, but with regard to pricing, they are still more sensitive to market conditions than competing lenders.

An aggressive S & L can compete with a strong community bank in funding local projects for local investors and developers. Larger Savings and Loans develop relationships with large developers and institutional owners for the placement of long-term permanent financing. It is generally easy to get to the decision makers in most Savings & Loans, and they typically welcome inquiries into developing new business relationships. Their fees and underwriting procedures are more akin to those of community banks, and are usually performed locally with minimal cost to the borrower. **I have had a great deal of success in my real estate investing career working with the Savings & Loans in my area, and prefer the personal relationship and "common sense" lending approach they possess in partnering with me on my projects.**

Insurance Companies

Insurance Companies are still active players in the commercial real estate mortgage market, although to a much smaller degree since the rise of the conduit lenders. They have large sums of money with a low cost to obtain these loans, and therefore usually only fund projects of $2 million in value and above. Their rates are typically lower than banks or Savings & Loans, more on par with conduit loans, but with much lower fees.

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Personal guarantees are typically not required, and they prefer to underwrite fully amortizing, long-term loans.

Insurance company loans can only be accessed through a network of mortgage bankers and brokers. They rely on these correspondents to screen and perform the bulk of the lender's underwriting, which means the process is typically less onerous than other lenders, but still very detailed.

Government Loans

FHA, HUD, SBA, and the many other government backed loan programs are readily available, but very difficult to navigate. The requirements and availability of funds changes from year to year, and I will not attempt to detail the various programs and the associated requirements for each. Any description I offer would probably be outdated the day I print it. In my experience, dealing with these loans is for those who have a great deal of time and a high threshold for copying documents in triplicate. That being said, there are many investors who have made a specialty of mastering government loan programs. A mentor of mine was a pioneer in the area of government backed financing for low-middle income multi-family projects. He developed dozens of communities throughout the Midwest after World War II and currently still owns and manages roughly 17,000 units. I admire his entrepreneurial vision and stand in awe of his tenacity and patience in dealing with and relying on the government to grow his business. But clearly, it has served him well and he is regarded as one of the country's leading investors using government backed funds.

There are many mortgage brokers and bankers who specialize in government funded and government guaranteed loans. There may be many more programs that I am not aware of, as this is an area of real estate finance that I have purposely stayed away from.

Loan Types

As important as finding the right lender is applying the correct loan type for the project at hand. The following is a list of the most common loan products for self storage facilities, and which lenders offer which types of loans.

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Credit Lines

Working Credit Lines are an excellent tool for short term funding needs. Credit lines aren't typically advertised or promoted because lenders typically only offer these loans to borrowers that they currently have a relationship with. A working credit line makes funds available to the investor on an as needed basis, and typically requires interest-only payments on the outstanding balance.

The majority of real estate investment credit lines are secured by equity in existing properties to support a business plan designed to acquire additional properties. The investor develops a business plan, and then he or she may approach several lenders to obtain competitive quotes for financing. The time needed for approval can vary widely from one lender to the next and is essential that the credit line be established prior to the need for funding. **The time to acquire a working credit line is before you uncover an opportunity.**

Terms of the loan vary but are typically 12 months or less, with an interest rate that floats with an index rate, usually the prime rate. The rate may be quoted in a range of one half to two points above prime. The fees associated with setting up the line are typically 1% of the face amount of the credit line charged annually. Closing costs are dependent upon the structure of the loan, paying close attention to the security, or lack thereof. The borrower's financial statements are required in addition to a personal guarantee. If the line is backed by real estate, the appropriate appraisals and title work will be required as well.

Most credit lines have an annual zero-balance and review requirement, meaning the line must be paid in full once each year. This is typically required to satisfy regulatory requirements for commercial bank audits, but is not as stringent as it sounds. Credit lines are intended to fund the initial acquisition of properties with minimum requirements for documentation, **allowing the investor to move quickly when opportunities appear** rather than having to apply for individual loans for each project. When the property is eventually sold or stabilized, the credit line is then paid off from the proceeds of the sale or by refinancing the property with a permanent loan.

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Construction Loan

A construction loan is used to build new facilities or used for construction of additional buildings at existing facilities. Loan amounts are typically for 100% of the cost of the improvements plus whatever additional soft costs the lender allows, if any. These are short term loans with a life of six months for smaller deals and up to two to three years for large projects. The bank holds the funds until invoices are presented for payments to vendors, usually on a monthly basis. The disbursements are called draws or progress payments and the lender may require an architect or loan officer to certify the degree of completion prior to each milestone and subsequent payment.

Monthly interest only payments are required and calculated on the outstanding balance for the period owed. It is common to include the interest costs into the loan amount, allowing the lender to hold the interest with each progress draw. The typical fee for the loan is a one-point origination fee on the total loan amount, plus any required inspection fees. Closing costs are minimal and limited to the document preparation and normal closing requirements.

Commercial banks and Savings and Loans are the most prominent construction lenders. This is a niche they dominate due largely in part to their proximity to the facility and familiarity with the investor.

Bridge Loan

The technical definition of a bridge loan is one used to fill a short-term need for funding between two related events with the same borrower. Timing issues may require the purchase of a property prior to the sale of an existing property. In this example, a bridge loan is arranged to fund the purchase and repaid from the proceeds of the property sold. Or perhaps an investor has a loan coming due but does not yet have a permanent finance commitment. A bridge loan can be used to pay the existing loan at maturity, and then be repaid from the proceeds of a permanent loan at closing.

The bridge loan is extremely flexible and is generally short term ranging from one to three years depending on the particular situation. It is similar to a permanent loan in that payments amortize the loan balance, but it can also provide funds for improvements with milestone draws like a construction loan.

Typical fees for a bridge loan are a one-point origination fee and standard closing costs. Third party inspections may be required if the improvement strategy is a major

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development project. Commercial banks and Savings & Loans are the lenders of choice for this loan type due to the flexibility and nature of the local contacts.

Portfolio Loan

A portfolio loan features an amortization schedule from 15 to 30 years depending on the facility, with a balloon payment due in three, five, or seven years. These are the most widely used loan products offered by commercial banks today for loans they plan to keep in their portfolio, hence their name.

Portfolio loans are preferred by banks mostly to offset interest rate risk. In today's volatile market, certain events can push rates up or down overnight, and that can significantly impact a bank's overall yield. The interest rates for portfolio loans are typically the lowest with the shortest term, and rise accordingly as the term increases.

Costs are similar to typical bank fees with a one-point origination and standard closing stipulations. Most banks will require standard third-party reports including environmental to limit their potential liabilities.

Balloon Mortgage

A loan that amortizes over a period of fifteen to 30 years, but has a balloon payment due in a shorter period, usually three to seven years, is generally called a balloon note or balloon mortgage.

Blanket Mortgage

A blanket mortgage is one loan secured by two or more properties. The loan is cross collateralized and the lien attaches to all properties that are listed as collateral.
Many secured credit lines may use this structure, but a pure blanket mortgage has an amortized payment schedule and a balloon payment at the end of three to seven years. The interest rate is priced at market rates and the length of amortization is determined by the facility. Typical fees include the 1% origination fee and closing costs can be expensive if a number of properties are being included as collateral. Each property must have a separate title report, mortgage instrument, survey, appraisal, inspection, and perhaps environmental report to be included in the loan package.

Commercial banks are the most common source of blanket mortgages as they typically have a better feel for the area, the property, and a relationship with the borrower. Some conduit and insurance companies accept two or more properties located in the same

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market under one loan, but not as a general rule. A blanket loan is most often used to combine several smaller properties into one loan in order to receive more favorable terms than any one of the properties would qualify for individually.

Mezzanine Loan

Mezzanine loans are secondary financing uses where the first lien holder does not allow a junior or second mortgage. The loan is secured by the borrower's ownership interest in the entity that owns the property; LLC or LLP shares, thus avoiding the first lender's restriction against a junior mortgage on the property.

A prerequisite for mezzanine loans is that the property is owned by a single asset entity. The term of the loan can be short or long and varies dependent upon the particular project at hand.

Fixed and Adjustable rate Fully Amortizing Loans

Fixed rate fully amortizing loans are now rarer than in years past. They are available, but rates will not be competitive with conduit loans or bank mini perms.
Terms can range from fifteen to 30 years.

Insurance companies, mortgage banks, and credit companies offer fixed-rate fully amortizing loans. Many government loan programs are also fully amortizing.

Adjustable rate fully amortizing loans are more common. Rates are typically in line with short term instruments and amortization periods are available from five to twenty years. Banks are the primary source of adjustable rate loans which are typically structured as a portfolio loan to be kept in house.

Choosing the right lender

No single loan type fits every deal so I first select the type needed depending upon the nature of the plan and then screen my rolodex of lenders for those who can get the job done. A simple phone call can usually determine if there is a fit between what I need and what the lender can supply. I am always sure to mention whether there is seller financing or anything out of the ordinary that may cause the lender not to consider the deal. **I don't want there to be any surprises at the closing table, and neither do my lenders**.

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Furthermore, any misrepresentations can carry serious consequences if it appears to defraud the lender. As I talk with the mortgage broker, I typically can get a feel for whether or not this is someone with whom I can do business. Likewise, if what he or she is pitching sounds too good to be true, experience has shown that it probably is.

Personal Guarantees

The typical personal guarantee within most loans is a pre-printed boilerplate document. It will contain language that is put there to protect the bank, not us. This document is a legal contract which is biased to the person who drafted it. **When possible, I will inform the lender that their document is in conflict with how my estate is organized and I will have my attorney prepare a guarantee for their review**. I stress the major points first to ensure that there is nothing discussed that will be a potential deal killer. **I try to limit the guarantee to 20% to 40% of the loan as a starting point**. The goal is to include language that reaches a predetermined amount that the guarantee will automatically be released.
Secondly, the guarantee should be secondary collateral, guaranteeing payment of any deficiency amount after the sale of the facility.

Often times, the lender will require a spouse to sign a guarantee. **The first step to avoiding this requirement is to omit your spouse's income or assets on your financial statement.** Another method often used is to place the asset being financed in a single asset entity like an LLC then assign a minority interest to your spouse in his or her sole estate. You can then take care of the transfer of interest to your spouse and family in a standard will or estate plan.

Asset Protection

Asset protection essentially involves placing your home and personal assets in various trusts and partnerships while still retaining control and listing them on your financial statements as ownership interests. Business assets can also be structured to minimize exposure to liability and outside claims. The force and effect of the underlying ownership structure makes the assets extremely hard to get to.

I am not an asset protection specialist, but know just enough that if structured properly, **it is essential to hold your assets in a manner that will protect you from loss.** I will touch on Asset protection later in the home study course in Chapter 15.

AVOID OVER LEVERAGE

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As I became proficient in the art of financing my self storage facilities, I have to remind myself that too much of anything can be harmful to my health, especially my financial health. When the income from a self storage facility is not sufficient enough to service the underlying debt, the result is negative cash flow, and could spell the death of your project, or worse. There are a number of ways to place multiple loans on a property with credit lines, private lenders, and bridge loans that will allow you to get into a property with $0 money down, or 100% leveraged.

Do yourself a favor; DON'T DO IT! ***I highly recommend sticking to a portfolio that is, at MOST, only 80% leveraged at any given time***.

There are rare exceptions that may cause me to look at going above this amount such as structuring an accrued payment loan from friends or relatives with deferred payments, or perhaps a killer deal with some highly unusual circumstances, but in 99% of the deals you will run across, it simply isn't feasible to generate your desired returns if you are over-leveraged. **Don't become a "don't wanter" a year later after buying a facility with 100% financing**, no matter what the other real estate investment gurus may tell you!

Building Banking Relationships

Dealing with a bank as a nameless faceless institution only gets you a nameless, faceless response, and probably not the one you desire. Bankers are judged on personal performance, so naturally they are attracted to good deals with good borrowers. I am always competing for my banker's attention with people like me that understand this, and I will go to great lengths to make it easy for the bank to say yes.

When I get to the business at hand, my loan proposal, business plan and financial statements are in order and can be left with the officer for review at his convenience. I also pay close attention to the "hero file" that I leave with him or her that details my list of accomplishments, previous deals, and lengthy resume highlighting my education, training and industry experience.

16 Ways to Find Cash for the Down Payment

In this section of the home study course, I will lay out several different ways to raise the cash for the down payment on your self storage facility. But once again I will caution: **I DO NOT RECOMMEND OR APPROVE OF 100% FINANCING, OR THE "NO MONEY DOWN" DEALS THAT YOU HAVE SEEN ON TV, OR HEARD OF BY OTHER AUTHORS AND SPEAKERS!**

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In the early stages of my real estate career, most of my single-family houses and apartment complexes were purchased with no money down and my entire portfolio was approached a 95% Loan to value ratio at one point. As a result, my cash flow was very tight, and when the rental market went sour after the events of 9/11, I came dangerously close to losing it all, and thought at one point that I may be heading for bankruptcy. Fortunately, by the Grace of God, and by employing the techniques I have learned and outlined in this home study course, I was able to turn things around and I was given another chance to learn from my mistakes. This is probably the biggest reason I have a passion for teaching others how to invest wisely, and how to avoid the mistakes that I, and so many others in this industry have made when it comes to over-leveraging their portfolio.

That being said, I have done several deals that have proven to be very successful projects which were purchased with no money down. The difference was that the deals were SO good, and the upside SO incredible, that I felt safe in leveraging them higher than my usual 80% threshold. In addition, I have structured the financing of my down payment on several deals in various ways to avoid a large drag on the cash flow of the property after acquisition. Furthermore, **I do not recommend that your portfolio ever rise above a level of 80% Loan to Value, especially if you are making regular payments on any down payment capital that has been borrowed.**

As you are already aware, there are several ways to raise cash for the down payment on your self storage deals. I will touch on some of them here while providing some of the pros and cons of each. I will then walk through the avenues I have chosen in raising capital for my own deals:

1. Savings

Cash is King! Obviously, if you have the cash, this is the safest and easiest way to fund your down payment. In addition, your lenders prefer to see that you have some of your own cash in the deal, rather than a down payment that is borrowed. Using your own cash will ensure that you will avoid becoming overleveraged, and is the most preferable to fund the equity portion of your deals. I will also include selling any CD's in this category as they are very liquid and easily converted to cash. Besides, if you follow my rules of investing in self storage, I can almost guarantee you will beat the returns you are currently receiving on your CD.

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2. Credit Cards

I know of many investors who have used credit cards to fund smaller deals, such as single-family houses. The downside of credit card financing is that you will pay outrageous interest, fees, and payments on a very small amount of money. Credit cards are probably not viable for the larger deals we are discussing in this home study course, but **I also do not recommend this method for any deal, no matter how good it may seem.**

3. Credit Lines

We touched on credit lines in chapter 11, but it is worth mentioning again for purposes of providing down payments. I established several small lines of credit with various banks in my community early on in my investing career. These lines were mostly unsecured, and typically ranged from $25,000 to $50,000 in size. The interest rates were slightly higher than secured loans, but significantly lower than the interest rates on credit cards. This strategy allowed me to purchase several deals that I may not have been able to do if I hadn't established these lines to use for funding my down payments. Once again, however, **you must be sure the deal can support the payments on both loans, and this is typically not a recommended method for financing the entire amount of your down payment.**

4. Home equity Loan

I have frequently used the equity in my personal residence to invest in other properties. The interest rate on home equity loans is typically cheap, and if the deal will support the extra payment, I won't hesitate to use this method. Again, a word of caution here, **if the deal is tight, and interest rates are high, the cash flow may not support this strategy**. You need to look at the cash flow of the facility including ALL loan payments to determine if the project will support 100% financing. If not, find another less costly way to fund the down payment, or walk from the deal.

5. Leverage equity in other properties

In several instances, I have borrowed against the equity in my existing portfolio to purchase additional investment properties. But just like a home equity loan, **you need to take great care in looking at the cash flow of the deal after factoring in the payments of both loans on the new project**.

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6. **Refinance Existing Properties**

As stated previously, virtually all of the properties I buy are "value-add" projects. Some need major repairs, others have high vacancies, and often they are mismanaged with low rents, or a combination of all three. Given that fact, I have bought these properties for 50 to 80 cents on the dollar. I have then rehabbed them, raised the income, lowered the expenses, and subsequently created a great deal of equity for my efforts. Once I have completed my renovations, and stabilized the property, many times I have refinanced them to pull out cash for the next value-add project. This is another one of my preferred methods for finding cash, so long as you **don't refinance more than 80% of the new appraised value.**

7. **Self-Directed IRA**

Self-Directed IRA's are a great vehicle for allowing me to invest the money in my IRA, tax free, in the business I love; Real Estate. In addition, I can set the terms surrounding how the funds are to be borrowed from my IRA, allowing me the utmost flexibility. **I purposely structure the loan from my self-directed IRA so that the interest accrues, and there are no monthly payments made until I sell a property, and ultimately pay back my IRA**. There are several companies that can act as the custodian of your self-directed IRA. I suggest you talk to several before choosing one that meets your needs. In addition, there are several transactions that are prohibited, so be sure to ask your custodian about the current laws regarding the use of your Self-Directed IRA for the purpose of investing in your own properties.

8. **Other People's IRA's**

I know of many investors who have had a great deal of success in educating other people on how to convert their IRA to a self-directed IRA, thereby allowing them to participate in the investor's real estate projects. **There are many people that are unhappy with their returns in the stock market, and are choosing to direct their own investments in higher paying securities, such as loans on real estate**. With real estate, they can see it, touch it, understand it, and the returns are generally spelled out in advance. And in most cases, the rate of return is much higher than they were realizing in the stock market, even on a good stock pick investment.

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9. Friends and Family

My Dad has been involved in several of my deals and it has worked out fabulously. He has some discretionary investment dollars that he has used to participate in a number of our deals. The beauty of this method is that my Dad does not require monthly payments, which would normally be a drag on the cash flow of the facility. Instead, we draft the promissory notes for approximately 3 years, with the interest accruing and payable only when the note matures, which is typically when I sell or refinance the facility. **This is another one of my preferred methods, but I will warn you to be very cautious not to bring friends and family into deals that may be potentially risky; you don't ever want to put yourself in a position where you may not be able to pay back family or friends for their investment in you or your deal!** I have included a sample **Promissory Note** that I use for these types of deals in the Appendix and on the forms CD.

10. Private Lenders

Private lenders can come from many different sources. It is a term that can include friends and family as we outlined above, or other individuals in the market that choose to partner with investors involved in real estate. The rates, terms, and appetite vary depending upon the individual's situation. Some individuals are happy to make 7%, will allow interest to accrue, and won't require any payments to be made for 5 to 7 years when the project is either sold or refinanced. Others may charge 5% up front as a fee, command 20% interest, and want regular monthly payments. It is best to shop around and ask others what the market is bearing at the time. I also recommend that you let people know you are in the business, and are actively looking for "passive investors" to take part in your successful operation. Some can be found in your local newspaper, and others are members of your local venture or investment clubs, including your local real estate club.

11. Seller Carry back

I have had a great deal of success in finding sellers who were willing to carry back a second mortgage on the property they were selling. For example, let's say I have a purchase agreement on a facility for $1,000,000. I will secure a 1st mortgage loan with one of my preferred lenders for the traditional 80%, or $800,000. The seller will agree to "carry back" the 2nd mortgage, or $200,000 with a note and mortgage secured by the equity (20% of the purchase price) in the facility he is selling, in which I will be attempting

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to acquire the facility for $0 Down. The note I have with the seller is typically drawn up at an interest rate that is roughly 1% to 2% higher than the one I have with the bank, and it is generally amortized over 25-30 years with a balloon payment that will come due within 3 to 5 years.

A sample Promissory note is included on the forms CD and in the Appendix. I will make monthly payments to both the bank, and the seller, paying the seller off in 3 to 5 years when I either sell or refinance the property. I prefer this method because of the low interest rate I can typically negotiate with the seller. But again, **this strategy only works when I am buying a value-add project where I can easily create value in the project to be realized in 3 to 5 years when I sell or refinance the facility**. And as I stated before, the project must support both payments out of cash flow when I take possession of the property.

12. Sell Existing Properties

If you have properties in your portfolio in which you have successfully maximized the profit potential, you may want to explore selling them to recapture your equity so that you can buy another value-add property. Each investor has different goals and perspectives on how they choose to run their business, and I, for one, choose to leverage my time and efforts by frequently trading in and trading up. I firmly believe the quickest path to acquiring wealth is by purchasing value-add properties, stabilizing them as soon as possible, and then selling them to capture the equity. I'll then take those proceeds and roll them into another, or several other value-add properties and do it all over again. However, there is nothing wrong with buying and holding great properties that cash flow. I do suggest however, that from time to time you look at your portfolio to determine if your equity and time is better spent selling a property or properties to take advantage of other opportunities in the market.

13. Sell Personal Property

Do you have a boat or third car that could be sold to buy income producing property? You may want to convert it to cash to jumpstart your career, or purchase another property. What else could you sell? Can you adjust your budget to begin saving for the down payment on a self storage facility? If you aren't already, **I suggest you spend more time thinking like an investor, not like the average consumer**. You will be amazed at how you will "find" the money if you set your mind to it!

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14. Borrow against your insurance policy

I have not personally taken this approach, but I do know other investors who have taken advantage of the ability to borrow against their insurance policies. Some insurance companies allow you to borrow against the cash value of your policy, and at rates better than those obtainable elsewhere. Check your policy, and with your agent to see if this may be an option for you.

15. Mezzanine Lenders

There are several companies in the marketplace that offer mezzanine financing, or bridge loans to "bridge the gap" between your first mortgage and the purchase price. Typically, they will provide another 5 to 10% on top of your 80% first mortgage, leaving you with a portion yet to be found in putting a deal together. The rate is typically 2-4 % higher than your first mortgage, and can carry some hefty origination fees and closing costs. I have not personally used this method to fund any of my deals, and again, **I don't recommend this method unless it is a fantastic deal with a tremendous amount of upside and positive cash flow to support the additional monthly debt service on two loans.**

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16. Bring in a Partner

I am not a big fan of partnerships, because typically, it involves “friends” that decide to go into business together without much thought. Unfortunately, in many cases, the partners almost inevitably have different views of how to run the business, and the friendship tends to suffer, and often times dissolves. In my case, the first self storage facility I ever purchased was with a partner where we each have a 50% ownership stake, and it has worked out fabulously. **In my opinion, however, the best way to structure a partnership is for the “money partner” to be a true “silent partner”.**

The silent partner’s role is to provide the down payment, but shares in the benefits of owning the facility. The remaining partner is the managing partner who runs the business and ultimately makes the lion’s share of the day-to-day decisions within the business. With regard to the debt placed on the property, in some instances both partners will guarantee the note and mortgage, and in other deals, only the general partner signs on the note and mortgage, with the silent partner contributing the equity or down payment. There are several ways to structure a partnership in order to purchase a self storage facility, and I strongly recommend that both sides are represented by an attorney to draw up the documents and review each side prior to closing the loan and taking title to the facility. In addition, be sure to give careful thought to the operating agreement of the entity that owns the property so that each party is clear as to what is expected of them going forward. The Operating Agreement is a separate document from the articles of incorporation which details how the business is to be run, and the responsibilities of each partner.

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Self Storage Profits Inc.

Self Storage Acquisitions

A step by step guide to creating wealth in self storage

CHAPTER 13

Creating Your Business Plan

Scott Meyers

Once I have an accepted offer, the clock starts ticking. We have several 3rd party reports which must be completed, and most importantly, we have to obtain a loan commitment within the specified timeframe spelled out in our purchase agreement. In an effort to ensure I am granted loan approval, it is critical that I submit a business plan that outlines everything a lender needs to know about me as a borrower, my business, and the project at hand.

Now for many people, the thought of creating a business plan is akin to the fear of public speaking. However, it does not have to be such an unpleasant task, especially since we already have the information. Our personal financial statement, the project due diligence and the market analysis comprise just about all of the information needed. All we need to do is to organize this information into a coherent document. Our business plan is an opportunity to present ourselves and the deal in the best possible light. **It is designed to give the lender an in-depth look at yourself as a borrower including your past successes, the reasons why this project is so strong, and the reasons it will succeed in this market.** This will all be supported by facts from your research and due diligence.

Reasons for a Business Plan

A written business plan speaks louder than anything you say or do when applying for the loan. In addition, a written plan may be the only information the loan committee or board can refer to when looking at your deal. **The business plan speaks for you when you are not present.** It is extremely important to create a professional, organized, document proving that you have done your homework and can manage the risk that is inherent in all facilities.

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There are several software packages and numerous resources available to assist you in preparing a business plan. Some are very good, but few are tailored specifically to real estate. I suggest you follow the format I have provided in this home study course for several reasons. Most business plan templates are just that; templates. They are designed using generic terms for operating a multitude of small businesses. However, a business plan and subsequent loan request for real estate requires many different elements. You may find that the effort involved in adapting a template is more work than writing a plan from scratch following the model I have presented.

In addition, I recommend writing your own plan because of the knowledge you will gain in the process of doing so. By assembling the information again and presenting it in a clear format, you gain an even better understanding of the project that allows you to explain it in detail when the time arrives. This creates a perception of confidence in the lender's eyes during conversations regarding you and the facility, and anything that reduces risk on the lender's part is a positive step in the right direction. Lenders see hundreds of proposals each year; some are good, others are not. A thorough plan makes their job much easier when pitching your deal to the board. I strive to ensure that my business plan and loan proposal are one of, if not the best proposals they will ever see. Some of **the smaller community banks I have relationships with only approve so many loans per year, and I want to make sure that my proposals make it to the top of the list** in the month that the committee or board meets to review and approve requests. And so far, I haven't lost yet!

I must remind myself that perception is a reality for the lenders. They do everything possible to avoid risk, but they know that every deal involves a certain amount. Their approach is to look at every deal as if it was a loser and must be proven to be a winner. My Personal financial statement is designed to project stability, and my loan proposal is presented in the exact same manner. A good loan proposal will convey the message that I have the necessary resources and abilities to succeed in the project being proposed. This is critical to obtaining loan approval and funding for the facility.

Elements of a Business Plan

The ability to professionally package and present my proposals, I believe, has been a major advantage in getting my deals funded. **My plans spell out very succinctly what I am going to do, when I am going to do it, and how I plan to do it.** In my opinion, there are seven critical elements that should be included in any business plan and subsequently, your loan application:

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7 Essential Elements of a Loan Application

1. Projected Financial Statement
2. Amount of Funds Requested
3. Requested loan terms and Length
4. Source of Repayment and collateralization
5. History of and nature of the Business
6. Repayment of the loan (including plan B should things go awry)
7. Timeframe for approval

I try to summarize those first 7 questions on the first 2 pages of my business plan to make it easy for the lender to get a quick snapshot of what I'm attempting to achieve. Remember, you are relying on your loan officer to present this request for you to the loan committee, so make it as all-inclusive, yet as simple as possible for him to do in your absence. Your ability to prepare your loan officer for this task will be the key element in gaining loan approval for your new facility.

Do not, I repeat, DO NOT send him or her in to the committee or the board with a disorganized, unprofessional mess of papers, and don't leave it up to him or her to explain why you should be approved for the loan. I spell this out myself in my business plan which highlights my experience, past successes, and my confidence in the project being proposed. They should come to the conclusion that if they don't fund this loan for me, then the competition certainly will.

Plan Format

My plan is written as a combination business plan and loan application that focuses primarily on the subject property I want to acquire. It includes a summary of my past experience and successes, my present portfolio of real estate, and pertinent financial data, but the primary focus is on the deal.

The reasoning behind my format is that a self storage facility is not a business that requires many employees, vast amounts of inventory, or major amounts of machinery to manufacture, distribute, or sell a product. With self storage, the emphasis is on the care of a single asset, and the plan is a representation of my ideas for the efficient and effective management of the facility. I'm not downplaying my ability as a borrower, but in commercial real estate, the lender tends to look more to the performance of the asset than the borrower.

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Below is a sample outline of a loan proposal and business plan. A good plan is professional, grammatically correct, free from spelling errors, logically organized, and most importantly, thorough. We will discuss these elements in the pages that follow.

1. **Summary Page**

    a. Borrower name and the entity that will hold title to the facility
    b. Property Legal Description
    c. Purpose of the loan
    d. Loan amount and terms requested
    e. Loan Ratio, or Loan To Value (LTV) requested
    f. Collateral and source(s) of repayment
    g. Financial Summary

2. **Market Summary and Analysis**

    a. Area map including facility, and photos of the facility
    b. Demographics: Population, growth, employment, & income
    c. Market Trends

3. **Neighborhood Analysis**

    a. Location Description in relation to customer base
    b. Market position
    c. Competition

4. **Property Description**

    a. Site plan and analysis
    b. Aerial and or Satellite Photo (GoogleEarth.com)
    c. Property Photos
    d. Property Description and Rent Roll
    e. Improvement plans
    f. Management Summary
    g. Marketing Plan

5. **Financial Data**

    a. 3-year historical financial performance (if possible)
    b. 3-year projection of operations

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c. Basis for these assumptions
d. Source and use of Funds requested

6. **Borrower data**

    a. Ownership structure and Entity
    b. Background and experience of principal
    c. Personal Financial Statement of borrower

7. **Exhibits**

    a. Building and site plans
    b. Survey
    c. Sample Lease

I will now discuss each section in detail and provide examples of the information that should be included for the lender:

Summary Page

A single page summary of the proposal presents the property and the loan request in Table Form. The summary contains all pertinent facts about the proposed facility and serves as an introduction to the project. It also serves as a quick reference for deal points so that anyone looking for the pertinent data does not have to search through the whole proposal to find an answer.

My layout is simple and concise. The headings address the pertinent questions of identifying the borrower, the property, and the purpose of the loan, the amount of funds needed and the terms for repayment, and the security and the source of repayment. Requested lending ratios are listed as well. Typically, the LTV and debt coverage ratios are the first calculations any lender performs when evaluating a loan request. I make it easy to find and discuss. I also highlight the operations and furnish supporting documentation for further consideration.

The summary supplies the answers to the most pertinent details of the project. The rest of my proposal will support the highlights with facts, figures, and further clarification.

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Loan Request Summary

Project:	Brownsburg Crossing Self Storage 1234, Secure Way, Brownsburg, IN 41111
Description:	143 Unit, 25,200 s.f. self storage facility on 4.1 acres
Borrower:	Alcatraz Storage, LLC, Scott Meyers, Managing Member
Purpose of Loan:	To fund the purchase of the existing facility and $15,000 in site improvements.
Loan Amount	$1,375,000
Terms Requested:	Fixed Rate Permanent loan at 80% LTV amortized over 30 years at current market rate, with no pre-payment penalty.
Collateral:	1st Mortgage on subject property with assignment of Rents and security deposits
Value:	Estimated Appraisal value of $1,750,000

Source of Repayment: Proceeds from the Net Operating Income of the facility

Projected Stabilized Income:	**Year 1**	**Year 2**	**Year 3**
Income	$218,484	$218,526	$220,134
Expense	$43,568	$43,124	$43,078
NOI	$174,916	$175,402	$177,056

Maps

Following the summary page and prior to the market analysis, I will insert maps that depict the location from both a regional, street level, and satellite basis. A local lender will invariably know the neighborhood and immediately be able to zero in on the location, creating a familiar feel right away

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Maps are readily available and free at websites such as mapquest.com and mapsonus.com. Satellite Maps are available at Googleearth.com which adds just another degree of professionalism and credibility to your plan.

A local map showing the property relative to area neighborhoods and services adds detail to the discussion regarding market position. For example, I show the location of the project in relation to any multi-family apartments, high density neighborhoods, and proximity to other retail related services when possible. I also try to stress visibility if the facility is located on a major road with high traffic counts.

Area Description

Most lenders already possess this data in lengthy form, so I prefer to use bullet points to highlight the major points. This also lets them know that I have done my homework and that I have a good grasp of the market I am planning to invest in. I will draw this from the demographic reports available at www.ESRI.com, and a sample of what I include in my plan is as follows:

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Brownsburg, IN, Hendricks County

- 72 square miles
- 125,789 residents
- 13 miles west of Indianapolis city center
- Highly accessible with a major highway, I-74, running through the city with an exit ½ mile from the subject facility.
- Indianapolis International Airport is located just 15 minutes away in neighboring Marion County.
- Major Employers include Hart Publishers, St. Vincent Hospital, and several Motor sport related Industrial complexes.
- Strong employment statistics: 2006 unemployment rate below 4%
- Average household income: $52,154
- Population growth trend +3.5% per year

Market Position

The information regarding the market should make the case for the project's viability. Again, I use bullet points to highlight the appropriate information. I typically use Information from the website of the local planning office, economic development department, and/or the local chamber of commerce. Also, be sure to credit the source or use your own words when doing so: Don't cut and paste from the website. Most likely, the lender and the committee members will be familiar with the local area's literature, but it doesn't hurt to re-state, and once again, it stresses your credibility in doing your homework.

Brownsburg Crossing Self Storage

- 25,200 square foot self storage facility
- Located off Dale Schrier Dr. near the intersection of S.R. 267 and 56th Streets. Also visible from I-74 on the North Side.
- Traffic count of 25,000 vehicles per day along 56th St.
- Less than one mile north of downtown Brownsburg off S.R. 267.
- Central to community facilities in a popular retail area.
- 17,543 households within three miles
- Average Annual Household income = $52,154
- Steady population increase of 3.5% over past 5 years
- Two competing self storage facilities nearby averaging 85% occupancy
- Located directly across from the Brownsburg Crossing Apartments, a 560-unit apartment complex

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- Significant barriers to entry for new competition due to the City of Brownsburg's reluctance to award zoning, and the rising cost of developable parcels.

The list should focus on factors that accurately reflect growth and stability in the area where the facility is located. The goal is to establish that the market exists to support the facility and my projections for future viability. Location in relation to high density neighborhoods and apartment complexes along with employment centers and other high traffic generators such as retail are key indicators that the project will sustain itself. If the market is not doing so well, I am sure to include information with regard to how our management efficiencies will allow the facility to achieve above average occupancy.

I am also careful not to ignore the likelihood of new competition. Local planning departments can provide information regarding proposed construction projects. If there are significant barriers to entry for new competition, then I will mention that fact and stress the point. However, I don't want to give the impression that although the lack of available land and difficult zoning actually benefits the existing facilities, but declining populations or high unemployment creates problems for all facilities.

Competition

The competition includes information for the subject facility and the pertinent information for each direct competing facility. The following is an example from the information gathered through The Self Storage Demand Estimator we discussed earlier, as sample of which is included in the Appendix and on the forms CD:

Competitive Supply within 5 Mile Radius

Facility	Square Feet	# of Units	$Rent/Square Ft.
Access Self Storage	56,000	445	$1.58
Best Self Storage	34,000	298	$1.41
AAA Self Storage	28,000	159	$1.78
U-Save Self Storage	19,000	141	$1.39

You can include further detail from the SSA Self Storage Demand Estimator with regard to demand and supply and an estimate of overall occupancy, but it may not be required. The point I am trying to make is that once again, I am demonstrating that the competition has been evaluated and the project is properly positioned. I will then summarize my opinion of the market position with regard to the subject facility and state

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my conclusions regarding future demand.

Property Description

This section details the actual physical features of the facility and includes photos, site plans, surveys, and perhaps charts. Any deferred maintenance and/or planned improvements are discussed along with a brief discussion of how I plan to manage the facility after acquisition. The site plan shows the buildings and improvements to the property, along with a unit breakdown if possible. I also try to supply an existing survey if I can obtain one from the seller. I will include the satellite photo as well, and discuss the site's topography, ingress/egress, parking, visibility, utilities and any special features such as a retail center, business office, kiosk, billboards, signage, cell tower, landscaping, etc. that may be worth noting.

Photos provide an excellent illustration of the facility. An aerial photo along with the satellite depiction from www.GoogleEarth.com or from www.terraserver.com can show proximity to neighborhoods, multi-family apartment complexes and the competition as discussed above.

If you are using a customer provided aerial, be sure to include the date and note any significant changes that have been made since taken.

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Facility Photos should include both interior and exterior views. If using a digital camera and editing software, you can add captions or short descriptions directly printed on the photo.

I also include a current rent roll summary which shows the unit mix and corresponding Rental Rates Like the one listed below:

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Management Summary Report

Printed On Friday, July 06, 2007 at 12:47:38 PM
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For Month Ending Saturday Jun 30, 2007

Alcatraz Storage at Airpark 321 W Riggin Rd Muncie, IN 47303

	Daily	Month-To-Date	Year-To-Date
From	6/30/07 0:00	6/1/07 0:00	1/1/07 0:00
To	6/30/07 23:59	6/30/07 23:59	6/30/07 23:59
Bank Deposits			
Cash	0.00	3,609.57	13,090.88
Checks	0.00	13,680.61	61,936.62
Charge	0.00	4,347.81	14,860.70
Total	0.00	21,637.99	89,888.20

Receipts

(Note: Receipts will not match deposits unless they correspond to the same periods. Deposits are based on fiscal dates. Receipts are calendar based.)

	Daily	Month-To-Date	Year-To-Date
Rent	1,027.00	20,813.42	88,936.06
Recur. Chgs	0.00	0.00	0.00
Late Fees	10.00	504.35	1,770.14
NSF Fee	0.00	0.00	25.00
Admin Fee	0.00	0.00	0.00
Reserv Fee	0.00	0.00	0.00
Insurance	0.00	0.00	0.00
Other Chgs	0.00	2.00	33.00
Misc Deposit	0.00	0.00	0.00
Overpmts	0.00	0.00	0.00
Sec Dep	0.00	0.00	150.00
POS	0.00	0.00	10.38
POS Taxes	0.00	0.00	0.62
Rent Taxes	0.00	0.00	0.00
Other Taxes	0.00	0.00	0.00
Total	1,037.00	21,319.77	90,925.20

Collections (Receipts collected in the reporting period towards rent.)

	Daily	Month-To-Date
Prepaid Rent	865.00	5,259.63
Current Rent	162.00	13,780.69
Past Due Rent	0.00	1,773.10
Total	1,027.00	20,813.42

(Receipts collected in the reporting period towards Late Fees #1, #2, #3.)

	Daily	Month-To-Date
Current Late Fee	10.00	251.85
Past Due Late Fee	0.00	252.50
Total	10.00	504.35

	Daily	Month-To-Date
NSF Checks	0	0
	0.00	0.00

Concessions (Credits applied to reporting period's charges.)

	Daily	Month-To-Date	Year-To-Date
Rent: Move-In	0.00	148.46	1,281.00
Rent: Move-Out	0.00	0.00	287.32
Rent: Other Periods	0.00	874.79	7,398.70
Late Fees:#1,#2,#3	0.00	669.00	3,149.46
Other Charges	0.00	0.00	6.67
Total Waived	0.00	1,692.25	12,123.15
Disc from Std Rent	120.00	1,935.13	7,217.94

Unit Activity

	Daily	Month-To-Date	Year-To-Date
Move-Ins	2	37	500
Insurance	0	0	0
Move-Outs	0	21	91
Transfers	0	1	12
Phone Inquiries	0	44	164
Walk-In Inquiries	0	30	123
Walk-Ins Converted	0	45	131
Letters Mailed	2	266	1586
Collection Calls Made	0	0	219
Payments Taken	18	293	
Fees Charged	0	180	
Merch. Sales	0	0	

As of Sat Jun 30, 2007

Rental Activity	Units		SqFt	
Rented Units	416	97.0%	66,461	99.0%
Vacant* Units	13	3.0%	650	1.0%
Unrentable	0	0.0%	0	0.0%
Complimentary	4		600	
Total Spaces	429	100.0%	67,111	100.0%
Waiting List	0			
Overlocked**	19			

			$/SqFt
Gross Potential Rent	26,976.00	100.0%	0.402
Gross Vacant Unit Rates	655.00	2.4%	1.008
Gross Occupied Unit Rates	26,321.00	97.6%	0.396
Actual Occupied Unit Rates	25,187.44	93.4%	0.379
Rental Rate Variance	1,133.56	4.2%	0.017
Effective Rental Rates	24,306.25	90.1%	0.366

Unpaid Charges (Curr Tenants)			Units	%GrossPot	%ofAc
0 - 10	56.80	0.5%	2	0.2%	0.2%
11 - 30	6,578.48	55.1%	44	24.4%	26.1%
31 - 60	3,309.74	27.7%	37	12.3%	13.1%
61 - 90	899.67	7.5%	8	3.3%	3.6%
91 - 120	50.00	0.4%	0	0.2%	0.2%
121 - 180	852.00	7.1%	2	3.2%	3.4%
181 - 360	203.00	1.7%	3	0.8%	0.8%
Total	11,949.69	100.0%	96	44.3%	47.5%

Delinquency (Current Tenants, 31 - 360 Days)

Units (rent only)	46	11.1% of Rented Units
Rent Charges	4,569.41	18.1% of Actual Month
Other Charges	695.00	

Liabilities	Units	$ Total
Tot Prepaid Rent	120	11,602.99
Tot Prepaid Insurance		0.00
Tot Prepaid Rec. Charge		0.00
Total Sec Dep		150.00

Rent Last Changed	Units	Var from Std Rate	Units
Leased 0 - 6 months	50	0 - 15%	46
6 - 12 months	0	15 - 30%	24
12 - 18 months	0	30 - 50%	5
18 - 24 months	0	> 50%	4
> 24 months	0	Total	79
Total	50		

Report Explanation

(*) Vacancies do not include unrentable units.
Complimentary units are counted as rented.
(**) Reported values reflect the current tenant status.
Gross Pot. Rent= sum of Std.Rental Rates as of the report date

Gross Occ Rate= gross of occupied units at the standard rates
Actual Occ Rate= sum of actual rental rates for occupied units
Effective Rate= Actual Occ Rate - Credit Concessions on rent for units occupied as of the report date.
Note: see Financial Help for analysis of Pot. vs Actual Revenue

Tot Prepaid Rent = amount prepaid as of the report end date.
Disc from Std Rent= discounts from current std (or prorated) rate

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I will also discuss the facility's general condition and occupancy history along with how I plan to improve the property by increasing occupancy, decreasing expenses, and whether I plan to construct additional buildings, install a kiosk, security system, fencing, electronic gate, etc. and the associated costs of each.

Management

Your plan for managing the facility is crucial to getting any loan approval. If you plan to manage the facility yourself, describe your history and experience in a format similar to a resume. If this is your first large property with multiple tenants, highlight your previous experience managing multiple smaller properties. And if you are new to the industry, focus on your people skills, organizational acumen, construction or remodeling experience, and all prior experience in real estate whether you have been a realtor, mortgage broker, appraiser, surveyor, or property manager; all can be talents you bring to the table.

I always discuss my experience and expertise in leasing, collections, maintenance, and my specialty, operations. I will also list the 3rd party vendors or contractors I frequently use to handle my lawn/landscaping, painting, door and spring repair, general maintenance, parking lot sealing/striping, and my property management software vendor. I will also identify who will be on-site to show prospective tenants, prepare the leases, take the service calls, and tend to the day to day operations of the facility, and the proposed hours of operation. If I plan to use a self-serve kiosk for 24-hour leasing and rental payments, I will also list that here, and include a brochure of our kiosk vendor in the appendix or attached in the body of the plan as reference along with their website address. In addition, if I plan to use a call center, I will note the name of the vendor and the hours I plan to utilize their services in addition to their brochure and website address.

Marketing

Depending upon the location of the facility, the current status of its marketing efforts, and the nature of any planned expansion, a detailed marketing plan may be required. The plan may include plans for new or additional signage, a name change, the yellow page and phone book ads, and perhaps some sample copy of your ads and brochures that will be available in the leasing office and distributed to the community. I also include the cost for updating any existing websites, or for designing one from scratch. For most facilities, a projection of an annual budget based on ad costs would be a good start. If this is a turnaround facility, or if I plan to add a significant number of new units, or specialized storage such as climate control, RV condos, or record storage, I may plan to expand my marketing efforts to advertise the newly repositioned facility.

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Financial Data

The financials are where the proverbial rubber meets the road. This will determine in the lender's eyes, as it already has in yours, that the project is viable. This is the section that will be referenced the most, so I am certain that it is accurate, and does not conflict with any other financials already presented, or in any other place in the loan request.

Most lenders like to see three years of operating history, and would also like to see projections for the following three years after purchase. I am always certain to explain any abnormalities in the financials should there be any drastic increases or decreases in income or expenses from the previous 3 years. I always pay close attention and include as much financial information as possible.

Don't forget your audience here; these folks want to see as much financial detail as possible which also includes narrative that tells the whole story. Not only are the lenders impressed with my preparation, but being thorough gives me confidence in the deal for my own peace of mind.

An example of an operating history for a self storage facility, which includes a pro forma for future years in the last column, is listed below

	20XX	**20XX**	
INCOME	Amount	Amount	Amount
Gross Rents :	$198,078	$201,768	$218,484
Parking :	$0	$0	$0
Truck Rental	$345	$437	$452
Revenues :	$198,423	$202,205	$218,936
Vacancy :	$0	$0	
Lease Variance :	$0	$0	$0
Concessions :	$0	$0	$0

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Effective Gross : $198,423 $202,205 $218,936

EXPENSES			
Real Estate Tax :	$15,600	$15,600	$15,600
Insurance :	$4,800	$4,899	$4,800
Management :	$14,536	$13,890	$10,400
Utilities :	$10,897	$9,267	$9,360
Payroll & Benefits :	$0	$0	$0
Contract Services :	$398	$412	$512
General & Admin :	$983	$467	$785
Repair & Maintnce:	$3,456	$3,789	$2,400
Advertising :	$974	$956	$1,008
Trash:	$412	$412	$399
Other:	$0	$0	$0
TOTAL EXPENSES:	**$52,056**	**$49,692**	**$45,264**
NOI	**$146,367**	**$152,513**	$173,672
Replacement Reserve:	$0	$0	$0

Cash Flow $146,367 $152,513 $173,672

If rental increases are based on the completion of improvements, be careful to account for the increased rents. The cash flow will increase over time, but not all in one year as the leases are almost always staggered, with an average tenancy running approximately 7 months. I am always certain to be realistic, both for the lender as well as myself when stating the projections for future years.

I always check all financial reports as well as all my statements two to three times for accuracy in reporting. If I make changes to the statements, I am always certain to change the statements in the text accordingly.

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Source and Use of Funds

A statement of source and use details the disbursement of the loan funds and my equity as borrower. It includes all closing costs including loan origination fees, attorney fees (if any), recording costs, escrows for survey, appraisal, environmental report, and any improvement costs. These figures are estimates and may change as the details of the purchase come together.

Below is a sample source and use statement for the acquisition of a self storage facility:

Source and Use of Funds

Brownsburg Self Storage – 650 N. Dale Schrier Drive, Brownsburg, IN
Borrower – Alcatraz Storage, LLC, by Scott Meyers

Funds Available	
Loan Principal Amount	$1,360,000
Borrower's Funds	$ 457,050
Total Funds Available	**$1,817,050**
Acquisition Costs	
Purchase Price	**$1,800,000**
Closing Costs	
Legal Fees	$1,000
Survey	$2,300
Appraisal	$3,600
Recording costs	$250
Loan Fees	$9,900
Total Closing Costs	**$17,050**
Total Acquisition Costs	**$1,817,050**
Balance of Funds Available	**$0**

This is final evidence of thinking the deal through. Addressing the transaction cost in an orderly fashion demonstrates that I have performed the necessary homework to establish the overall feasibility of the deal.

If the facility plan includes loan proceeds to fund any improvements or expansion, I will include a line item schedule of funds requested.

Borrower/Entity Structure

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Every lender needs to know who the borrower is. **I always set up a separate legal entity, typically an LLC, to hold title to each facility I purchase**. I will include details of the ownership structure including percentage of ownership and a copy of the articles of incorporation, approved by the state of Indiana, and a copy of my operating agreement. In addition, I will list my tax attorney, and legal counsel for reference.

Background of Principals

The final section of my loan proposal includes a very lengthy "hero file" where I detail my past experience and investment successes. It is a separate, spiral bound booklet that lists in detail a breakdown of the deals I've done in the past, highlighting the profits on the sale of each property. I will also include a list of current facilities in my portfolio, focusing on the increase in Net Operating Income of each facility after I acquired the facility and implemented my best business practices in operations and management. I also include a resume outlining my formal education and industry training, designations, and a list of my awards and recognition. I round out the resume with notes on my family and extracurricular hobbies and interests. **I am a firm believer in adding a personal touch to my plan which helps to find common ground with my lenders and the committees that will ultimately review my request.**

Exhibits

I include as much information in the package as will help to sell the project. At times, I may overdo it, but I would rather err on the side of producing more than enough information for the lender to make a decision, rather than omit what they may be looking for. Tax returns, detailed vendor contracts, proposals for improvements, etc. should be referenced as "available for review upon request, but not included with this proposal".

Packaging

I prefer to copy the package on 3-ring paper, and include in a binder with tabs for reference. Any one of the large office supply stores can assist you with this document at minimal cost.

Remember, **our goal is to have our loan proposal moved to the top of the heap when all the loans are proposed at the monthly loan committee meeting, and ultimately, given preferential consideration for being so professional and complete.**

Make it generic in nature, but include a formal cover to the bank and lender you are making the request to. There have been a few occasions where the lender wasn't able to

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fund the loan for some reason, in which case I would retrieve the package and forward it to another bank to start the process over.

In Summary, when I have taken the time to prepare a thorough business plan and loan request, it has been given the attention and priority it deserves. And subsequently, I have had a great deal of success in getting my deals funded, and grow my business in ways others have failed.

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CHAPTER 14

Tax Planning

Scott Meyers

If you intend to invest in self storage facilities, or in any form of commercial real estate, and plan to assume all the headaches, risks, and hard work that is required, then I presume that you expect to make (hopefully) a very large profit. If you plan to work hard, smart, and join the ranks of “The Rich”, then be prepared to, unfortunately, pay a disproportionately larger share of taxes than most people in this country. Taxes will no doubt be one of your biggest expenses, if not THE biggest. The purpose of this chapter is to prepare you for the major tax issues that you will face, and hopefully help you to reduce your tax bills to a more palatable size.

There are over 500,000 pages of federal law that pertain to taxes, and none of it makes for interesting reading. I have chosen a few specific issues that are worth addressing, but I don’t plan to go into a great amount of detail. If you want detail, I recommend you talk to your local tax and legal advisors, and if you don’t currently have advisors, I strongly recommend you begin talking to your trusted inner circle and ask them to refer you to good, competent, legal counsel that you can add to your team.

Rental Income

Obviously, one of the major income generators for self storage facilities is rental income. Rental income is considered ordinary income by IRS guidelines. That means that it is taxed at the taxpayer’s ordinary rate, which could be as high as 40% for investors in a higher income bracket. For those taxpayers, the immediate tax savings from a depreciation deduction of $10,000 equals $4,000. As a result of the deduction lowering the basis of the property by $10,000, the subsequent gain upon the sale of the facility will be increased by $10,000. The benefit is that the recapture tax on real estate is less than the initial $4,000 benefit, and is usually taxed at a flat 25% rate. Therefore, the $10,000 gain generated by the $10,000 depreciation deduction creates a tax of $2,500 even though the original benefit was a tax savings of $4,000. Thus, depreciation on real estate provides a benefit today in exchange for a deferred and reduced cost in years to come.

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If the facility is never sold, then recapture never occurs, in which case the depreciation deductions become permanent tax savings, as opposed to an NPV benefit. Holding the facility until death triggers depreciation deductions from tax rate arbitraged loans into gifts.

Capital Gains

The second major income generator in self storage next to rental income and therefore is subject to taxation, is the sale of your facility. The amount of taxable gain is equal to the amount realized (sale price) less the adjusted basis (the amount invested in the facility) minus any selling expenses. The amount realized generally equals the sale proceeds received at the closing plus the fair market value of any property received. Any seller carries backs that the buyer receives from the seller are still treated as cash paid to the seller, and therefore subject to tax.

So how is the gain taxed? 1st, we break out the amount of gain that is attributable to depreciation. This portion of the gain is commonly referred to as "recapture", as in we are "recapturing depreciation". True recapture is only the amount of depreciation that has been accelerated in previous tax years. In simpler terms, "recapture" refers to the total amount of depreciation that has been taken over the life of the asset, while "true recapture" refers to the amount of depreciation that has been taken in an accelerated fashion.

The 2nd Step is to determine whether the recapture is attributed to real or personal property. In other words, was the depreciation taken based on the building itself, or was there some personal property depreciation taken on computers, furniture, tools, office equipment, etc.

The 3rd step is to then determine whether the depreciation taken was done in and "accelerated depreciation" method or through the "straight-line depreciation" method. The tax rate applied to real property recapture is based on two considerations:

a. To the extent of true recapture, the amount of gain is taxed at the taxpayer's ordinary tax rate.
b. Any remaining recapture (the straight-line depreciation) is taxed at 25%.

The 3rd step is a simpler calculation for personal property as all recapture on personal property is taxed at ordinary rates.

The 4th step is to determine the rate that applies to the remainder of the capital gain (the total gain minus the recapture). The rate at which the capital gain is taxed is dependent upon two factors: How long did you own the facility, and what is your tax bracket. More

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specifically:

a. If you owned the facility for less than one year, the amount of gain is taxed at your ordinary tax rate.
b. If you owned the facility for more than one year and you are in a tax bracket that is higher than 15%, then the gain is taxed at 20%
c. If you owned the facility for more than one year and you are in a tax bracket that is 15% or less, then the gain is taxed at 10%.
d. If the facility was purchased after 12/31/00 and you owned if for more than five years and you are in a tax bracket that is higher than 15%, your gain will be taxed at 18%.
e. If the facility was purchased after 12/31/00 and you held it for more than five years and your tax bracket is 15% or lower, your gain will be taxed at 8%.

Deductions

There are far too many deductions to cover in this home study course, nor can I go into much detail, so I'll just do a quick overview. One of the most important things to note about deductions is that they have tax value in that they reduce taxable income, typically dollar for dollar. For example, $100 of rental deductions reduces your taxable income by $100, which means a $40 income tax reduction. However, don't confuse this with a tax credit which reduces your tax dollar for dollar. In the above example, a $100 credit reduces taxes by $100. So, dollar for dollar, you can see that a credit is more valuable than, and treated much differently than a deduction.

Most operating expenses are incurred as a result of running your facility on a day to day basis, not because you planned for them to benefit you from a tax planning standpoint. However, there are deductions that you can plan in anticipation of certain deductions. Some examples of those PLANNED expenses are as follows:

- The characterization of capital improvements as either an immediately deductible expense, or a depreciable improvement, (paving the lot, or replacing the roof).
- Conversion of verifiable personal expenses that are truly business deductions, such as a self storage seminar or trade show.

Most deductions generally available to small businesses are generally available to self storage investors. There are typically two basic categories of expense from a self storage facility:

- Those expenses incurred in an income-producing activity

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- Those incurred in the course of an active trade or business

The difference between the two involves the level and the type of activity involved in the business. A passive investor, who owns a facility as an income-producing asset that is professionally managed, but with direction from him or her, is in a trade or business. Any further involvement by the investor would put him or her in the active trade or business category. Generally, deductions for a business include the following items:

- Almost all Taxes
- Meals and Entertainment
- Travel and Lodging
- Transportation
- Employee salaries and benefits
- Repairs and Maintenance
- Sales expenses
- Advertising
- Interest
- Education
- Office-related expenses such as phone, office supplies, etc.

Value of Deductions

The basic value of a deduction is the amount of taxes that it will save us. For example, a $100 deduction will save a taxpayer in the 40% tax bracket $40. However, not all business expenditures will generate the same amount of tax deductions. Some expenditures allow you to take deductions immediately, and some provide for a string of deductions over a number of years, and some even allow a deduction only when the facility is sold. Therefore, a more accurate measure of the value of a deduction is to calculate its net present value (NPV). For example:

- Yellow page ads are almost always deductible in the year they were paid. Therefore, $1,000 of advertising expense paid in year 1 has an NPV of $400 in tax savings.
- A $1,000 expenditure on personal property that is depreciable over 6 years has an NPV of $334 in tax savings, assuming a discount rate of 12% for purposes here. In other words, the string of deductions spread over 6 years is worth less than an equal deduction that can be taken in this tax year.
- A $100,000 expenditure on a building that is depreciable over 40 years has an NPV of $8,994 in tax savings. In other words, the string of deductions is spread

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over 40 years and worth much less than an immediate deduction or even the same deduction spread over only 6 years.

- Cash expenditures for land are capitalized equal to the basis of the land. Land is not depreciable, so it generates no depreciable deductions. The basis in the land only offsets the income when the land is sold off. Therefore, if the land were sold in 40 years, the NPV of tax savings attributable to the basis in the land would equal $430.

In summary, from a net present value standpoint, your ability to deduct an expense today is worth far more than the ability to deduct the expense tomorrow, or over the course of several years. Given the manner in which NPV is calculated, a major tax objective is to accelerate deductions whenever possible.

Depreciation

The major advantage of real estate over the stock market is that real estate almost always allows for depreciation deductions, where stocks do not.

Investments in a depreciable asset, such as a self storage facility, are deducted over the “depreciable life” of the facility, as opposed to investments in non-depreciable assets, which are available to be deducted when the facility is sold. The NPV of a string of deductions over the life of an asset is much greater than the NPV of an equal deduction when the facility is sold. Therefore, the ability to depreciate a self storage facility has a high value from a tax savings standpoint, in contrast to non-depreciable investments such as those found in the stock market.

The depreciable life of an asset, unfortunately, is arbitrarily set by Congress and the IRS and bears no resemblance to the actual economic life of a facility. A percentage of the facility’s “basis” is allowed as a deduction for every year of the facility’s life. The longer the life of the facility, the lower the allowable annual percentage, and the lower the annual deduction. The annual deduction is referred to as depreciation if the asset is tangible and amortization if the asset is intangible. When expenditures are made to purchase or improve, or expand the facility, those expenditures are added to the facility’s basis. The additional basis is then depreciated over a term of years by depreciation and amortization deductions, the same as the original investment in the facility. The amount of permissible annual deduction is spelled out in the various IRS tables as a percentage of the facility’s total basis. As a facility incurs depreciation deductions, its basis is reduced by the amount of the deductions, increasing the amount of gain realized when the facility is sold. In summary, depreciation deductions provide tax savings now, in exchange for a tax cost down the road. One dollar in benefit now in exchange for a like one-dollar liability later is

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much more advantageous from an NPV standpoint. And the benefit is even greater for high bracket taxpayers.

Alternative Minimum Tax & Depreciation

AMT is painful to take and difficult to calculate. How it works: Your income is recalculated after subtracting certain adjustments. One example is being forced to recalculate the depreciation on the facility. Typically, the recalculation occurs at rates that are much less favorable than the typical rates and therefore reduces the overall depreciation deduction and increases the income for AMT calculations. Once any and all adjustments have been made and applied to your taxable income, it's time to recalculate your taxable income (hint, increased!). At this point, a rate of 26-28% is applied which results in your alternative minimum tax. If that AMT is higher than the income tax that you have already actually paid, then you have the privilege of paying the difference between the two. This new payment also serves as a credit against future ordinary tax liability, and unfortunately, but not unexpectedly, does not count as a credit against future alternative minimum tax.

Taxpayers have the option to depreciate real property, such as a self storage facility, on a property by property basis over 40 years. This will reduce the depreciation benefit, but it can also allow us to reduce and sometimes avoid the alternative minimum tax liability. Taxpayers can also choose to depreciate personal property in a straight-line fashion over the longer AMT periods or straight-line over the standard depreciable lives. Unlike the real property option, which is calculated on a property by property basis, the personal property calculation applies to all assets in the elected class placed in service for the year of the election. The decision to make any of the preceding elections involves many individual factors, including other preferential items, marital status, level of income, etc.

AMT can reduce, but not eliminate the NPV of depreciation deductions. An analysis should be made to determine which option is best for self storage facilities and properties with shorter lives. The options typically are to take full depreciation and suffer the AMT, or elect the 40-year period and reduce the AMT. And as always, I highly recommend you consult your tax advisor on which election benefits you the most.

Bookkeeping

Doing the books, yourself is feasible with smaller facilities if you possess the correct skills. What I mean by correct skills is adept enough in accounting to understand:

- The difference between cash and accrual method of accounting and how to properly log accounts receivable and accounts payable

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- The tax rules that determine whether an expenditure can be immediately deductible or treated as a capital expense.
- How to calculate and segregate principal and interest payments especially if they are paid late or not the same amount as listed on the loan schedule.
- How tax depreciation is calculated
- A good understanding of the accounting or property management software used to track all this data.

The larger your operation gets, the less efficient if becomes to feasibly keep your own books, much less keep up on the latest in accounting principles and changes in the laws. **I strongly recommend you do your homework and interview several bookkeepers, tax return preparers, and tax advisors before making a decision.** Sometimes one person can fill all these tasks, but often times you may need more than one individual. **I will also strongly suggest that as you grow, you look to consult with a Chief Financial Officer (CFO), even if it's a part-time person or small company, to help guide and advise you on the financial end of the business**. And if business really takes off, hiring a full time CFO will reap huge benefits as you grow.

Some things to keep in mind as you are building this part of your team:

- Specialized experience in dealing with Real Estate investment, and self storage in particular.
- I also try to find advisors who own real estate or self storage themselves, ensuring that they really do know the business.
- The ability to communicate their findings in a very simple manner for both you and your banker to understand.

This is an area that I overlooked early on in my investing career, and it suffered greatly as a result. If your books are a mess, then chances are your business is as well. There is no way for you, your lender, an appraiser, or a potential buyer to know how well you are performing unless you have a solid handle on the financials.

1031 Exchanges

1031 exchanges or like-kind tax deferred exchanges can be quite involved. However, understanding the benefits of IRC Section 1031 should provide enough benefit to do your homework. As we have already discussed, real estate is heavily tax favored because it allows for depreciation deductions and is often taxed at relatively low rates upon a sale. However, a sale can still trigger a substantial and sometimes surprising tax

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bill. Section 1031 is designed to provide a means of deferring taxes paid by the seller upon the disposition of a property.

For example, let's say that I purchased a self storage facility for $1,000,000 with $30,000 of my own money in the deal. After 4 years, I had received $6,000 in depreciation, and I have now decided to sell. I have decided that I want to try to do this again so I am left with several options:

Option 1: Cash Sale

I can sell the property for cash. This sale would generate taxes of $195,000 ($1,500 on recapture taxed at 25% and $194,000 on capital gains taxed at 20%). I can then reinvest the remaining $814,500 in additional self storage facilities.

Option 2: Simple Swap

I could find another self storage facility that:

- Is worth $1 million
- That is more desirable to own
- With an owner that wants the one I'm trying to sell.

Such a facility could simply be swapped for my existing property. From my tax standpoint, my position would be completely unchanged. The new facility (or my replacement property) would have the same adjusted basis as my old facility (the relinquished property). I would continue depreciating the replacement facility exactly as if it were the relinquished facility. To simplify, the address has changed, but the tax characteristics remain completely unchanged. I am able to invest the full $1 million-dollar FMV of my old facility into the new venture, instead of a mere $814,500 in after tax proceeds.

Unfortunately, most of us will not find the perfect property with an owner that just happens to want whatever property it is we wish to relinquish. Given that, it is unusual to find many direct barter exchanges in the marketplace.

Option 3: Swap with Cash

Let's assume that I have found a smaller facility worth $500,000 that fits my investment goals. The owner is willing to give me the property and $500,000 cash for the facility I am choosing to sell. The cash is referred to as "boot" as in "I'll give you my property and some cash to "boot". The boot is not considered like-kind as it is subject to tax. The general rule is: A like kind exchange is taxable on the lesser of 1) the boot

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received or 2) the amount of gain that would arise upon a cash sale. In our case, the amount of gain that would be realized upon a cash sale of our existing facility equals $876,000 ($1,000,000 FMV less $124,000 adjusted basis). The amount of boot equals $500,000 and $876,000. As compared to a cash sale, I will be able to defer $376,000 in taxable gain ($876,000 in potential gain, less $500,000 actually recognized).

The basis of the replacement property equals the old carryover basis plus any gain recognized on the exchange, for a total of $624,000 ($124,000 carryover basis plus $500,000 gain basis). The carryover basis continues to be depreciated as if nothing happened. The gain basis is depreciated as if it were used to purchase the new building on the date of the exchange. Because I have been depreciating the carryover basis for 4 years now, the carryover basis portion will be fully depreciated 4 years before the new gain basis portion, which is depreciated as if it were placed in service on the date of the exchange.

The best way to understand what happened in our example is to imagine that two separate deals actually have taken place:

- Deal one is the cash sale of a portion of the facility I am choosing to sell for the $500,000 boot, with the entire $500,000 being used to purchase $500,000 worth of the replacement property.
- Deal two is the exchange of a portion of the facility I am choosing to sell for the remaining portion of the new property.

Option Four: Swap with Non-Like-Kind Property

I am interested in a $500,000 racing track in a rural town in Indiana that someone is trying to unload. The owner is willing to give me the old dirt track and some racing equipment in exchange for my self storage facility. The racing equipment and my facility are not like-kind property. Non-like-kind property is treated as boot to the extent of the property's FMV, so the racing equipment is treated as boot. Therefore, the gain on the transaction is $500,000, based on the same reasoning that applied in Option Three, above. The real estate replacement property gets the carryover basis of $124,000. The racing equipment gets the gain basis of $500,000. Therefore, the results are the same as in Option Three, except that the gain basis gets allocated to the non-like-kind property received, instead of to the like-kind replacement property.

Option Five: Swap with Debt Relief

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Assume my existing facility has a mortgage debt of $500,000. The owner of the race track in the above example is willing to give me a $500,000 racetrack, and assume my $500,000 mortgage in exchange for my self storage facility. The assumption of the mortgage by the owner of the race track is termed “liability boot” to me and is treated exactly like cash boot in calculating how much gain is recognized on the transaction. Giving me cash is basically the same as him giving me cash with a loan and then handing the loan liability off to him. Therefore, the result here is exactly the same, once again, as in Option Three.

Option Six: Swap with Offsetting Liability Boot

Assume that my self storage facility has a mortgage debt of $500,000. The owner of the race track is willing to trade his $500,000 property and assume the $500,000 mortgage on my facility in exchange for my facility. In addition, I will assume a $200,000 mortgage that he has on his race track. In order to determine the amount of liability boot, offsetting liability assumptions are calculated to determine the final liability boot for the transaction. In this case, the owner of the race track assumed $500,000 of my self storage facility debt, but I also assumed $200,000 of his debt. Therefore, the net liability relief is $300,000 in my favor. I am therefore shown as having received the race track plus $300,000 worth of debt relief. The result is the same as if I had received $300,000 in cash. I other words, I recognized $300,000 in gain (which is much less than the total potential gain of $876,000) and the replacement property, the race track, has a basis of $424,000 ($124,000 carryover basis + $300,000 in gain basis). Of the potential gain of $876,000, $576,000 ($876,000 less $300,000 actually recognized) has been deferred.

The rules for determining exactly when and if opposite grants of boot offset one another are much too involved to discuss in this chapter. Several generalizations can be made about boot offsets, using the above referenced examples:

- I may offset liability assumed by the race track owner dollar for dollar by assuming the debt on his property.
- I may offset liability assumed by the race track owner dollar for dollar by paying him cash.
- I may offset cash received from the race track owner dollar for dollar by paying him cash in return
- My assumption of his debt will not offset cash paid to me by the race track owner.

Option 7: Deferred Exchange

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Let's assume that I really don't care for the race track or feel it's overpriced. I will then assume to enter into a "deferred exchange", which is really a sale followed by a purchase, but treated as an exchange by the IRS. I sell my facility and a "qualified intermediary" collects all of the sales proceeds. A qualified intermediary is a middleman that is qualified to handle a sale and purchase into an exchange. It's important to note that if I control or receive the sales proceeds, termed constructive receipt, even indirectly, and for a short time, the whole transaction is treated as a "taxable sale" followed by a purchase. Constructive receipt of sales proceeds nullifies a deferred exchange, which is why I strongly recommend using a qualified intermediary.

A deferred exchange gets its name because I can sell my facility tax free, but defer the acquisition of the replacement property for a time. As of the date of this publication, the law reads that we have to identify a potential replacement property within 45 days. During that time, I have the option to:

- Select three potential replacement properties
- Select any number of potential replacement properties, so long as their aggregate FMV is equal to or less than two times the FMV of the relinquished property

My selection must be made in writing, and I have 180 days from the sale of my relinquished property to actually close on one or more of the selected properties. The 45 day and 180-day deadlines are very strictly enforced. If either is missed, the tax-free exchange becomes a taxable sale followed by a purchase.

If the replacement property is worth less than the proceeds generated by the sale of the relinquished property, I will scramble to buy additional property within the permitted period to avoid the tax penalty. If the period runs out and I have leftover sales proceeds, I will be subject to paying taxes on the gains (boot). If my replacement property costs more than the sales proceeds, I will then take out a loan for the difference needed to purchase the property. Therefore, the taxable gain on the relinquished property is completely deferred, and the additional funds used to acquire the replacement property add to that property's basis. **As a general rule, trading up in value defers gain, while trading down in value triggers gain.**

Deferred exchanges are a very flexible tool which allows you to avoid and defer paying taxes on our profits. The reason I try to avoid taxes is very simple: **the more money I have available to invest, the quicker I can build my portfolio**. It's as simple as finding a seller who wants cash for his property within 45 days, and another 135 days to close.

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Option 8 Reverse Deferred Exchange

Let's say I found a $1 million property that I had to close on quickly, and did so. If I structure this correctly, this purchase could be followed by the tax-free sale of my existing facility referred to in previous examples. The IRS has issued "safe harbor" rules for reverse exchanges. The safe harbor rules are similar to deferred exchange rules described in Option Seven. Reverse Exchanges can also be completed without following the IRS safe harbor rules, but you run the risk of being challenged.

Option 9 Build to Suit

Let's assume I want to use the proceeds from the sale of my existing facility to build a new facility across town. I also have the option of doing so, tax free. There are primarily two different ways of achieving this. First, a builder has to acquire the land and build upon it to my facility design and specifications. I will then take the new build in exchange for the facility I just sold, or I will enter into a contract to sell the existing facility and assign the contract to the builder.

The other method is to enter into a deferred exchange as explained in Option Seven. I will sell the existing facility and forward the proceeds to a qualified intermediary. The intermediary will then pay the builder. The problem with the deferred exchange is that the builder only has 180 days from the sale of my existing facility to complete the construction.

Like – Kind Definition

For the replacement of a relinquished property to be treated as a tax-free exchange, the replacement property must be of like-kind to the relinquished property. Real property and personal property are subject to different rules in determining whether the replacement property is actually like-kind.

The like-kind rules for real property (real estate) are fairly liberal compared to the rules that apply to personal property. The following categories of real estate are considered to be like-kind to one another:

- Single family houses
- Apartment Buildings
- Raw Land
- Interests in a Land Trust
- Tenants in common Interests

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- Remainder interests in real property
- Some timber interests
- Some oil and gas interests
- Commercial buildings (self storage)
- Condominium interests
- Easements
- Life estates in most properties
- 30-year leasehold interests
- Contracts to purchase real estate

Personal Property

The rules for personal property are stricter. Assets in the same ADR class that is used to categorize property at your facility for depreciation purposes are like-kind under Section 1031. If two pieces of personal property are not within the same ADR class, such as a computer vs. the lawnmower, they may still be considered like-kind as part of the operations of the two facilities. There is a very gray area on this point within 1031 laws. What little guidance there is can be argued by focusing on the use of the personal property in the day to day operations of the facility.

It is important to break out and segregate the separate components you plan to exchange within your accounting. If the personal property was separated from the real property to take advantage of a shorter depreciation period, then segregate the personal property on the purchase agreement and in your exchange documentation with the intermediary. In short, make separate lists of the personal property at both the relinquished facility and the replacement facility. And remember, if you sell a facility full of personal property, and buy, say a new construction as a replacement with no personal property, you will pay taxes on the sale of the appliances.

When Not to Perform a 1031

If the sale of a property would generate a loss, I recommend avoiding anything that qualifies as a like-kind exchange that would defer the loss. If selling at a loss, be sure to receive cash and I strongly urge you to delay the purchase of another property for a few days if possible. The reason behind this is that the IRS could characterize your sale as a like-kind exchange and defer your loss.

Another reason not to perform a 1031 exchange is if you have losses that carry forward from previous years or credits that will expire in the near future. If the losses expire, you will lose them to shelter income in the current tax year. Therefore, it may be advisable to

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generate income by a taxable sale to make use of those losses before they expire.

Death

Strangely enough, death is part of good tax planning. In addition to triggering estate taxes, dying also has income tax ramifications. What happens is that the basis of a property held at death gets stepped up, that is, the basis is now increased to the fair market value of the property. For example, if I die and leave a facility with a basis of $10,000 that is now worth $1,000,000, the basis of the property is increased, or stepped up to $1,000,000. My heirs could therefore sell the property and pay no income tax upon the sale, because the basis equals the FMV. The other option would be to hold on to the facility and get depreciation based on the $1,000,000 basis, or around $26,000 in depreciation per year!

The drawback is that prior to the step up, the facility is subject to estate taxes. The rate of taxation will depend upon the size of my estate upon my death. If I left too much behind, my estate will get taxed at roughly 55%. The way to avoid both the estate and income tax is to slowly gift the property to my heirs, one facility at a time. They can continually exchange the property for years to come, deferring the massive tax liability with these low basis, high value facilities.

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CHAPTER 15

Entity Selection

Scott Meyers

We real estate investors have numerous options when choosing the type of entity through which our businesses will be conducted. In most instances, the tax characteristics of each type of entity will drive the selection process. A brief description of the various types of entities is as follows:

Sole Proprietorship:

A sole proprietor conducts business in his or her own name. Taxes are paid on Schedule C or Schedule E of the taxpayer's form 1040. All the liabilities of the proprietorship are liabilities of the owner, including all loans, accounts receivable, contracts, and even court judgments. In today's litigious society, a mistake and subsequent lawsuit can totally wipe out the life work of the owner. Given how cheap it is to form corporations and LLCs, **I strongly recommend conducting business in one of those entities and NOT as a Sole Proprietor.**

General Partnership

A General Partnership exists when several people do business together with the intention of making a profit. No formal agreements are necessary for state or tax law purposes. The simple act of doing business together creates the obligation to file Form 1065 (partnership tax return) with the IRS. Also, the simple act of doing business together can cause each partner to be completely liable for the actions of the other partner(s) even if the actions are prohibited by the others. In legal terms, this is known as joint and several liability. If your partner makes a mistake, you could be sued and possibly lose everything you own. **It is for this reason that I strongly urge you not to enter into this type of arrangement, but perhaps to seek a partnership between two entities such as corporations, or two LLCs, rather than as individuals.**

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One of the benefits of forming a partnership is the tax advantages that they provide such as:

- Partnership income is only taxed once, as opposed to C-Corporation income which is taxed twice.
- Partnerships can usually distribute money or property tax-free, unlike corporations.
- There is a great deal of flexibility in allocating income and tax benefits. For Instance, one partner can take all the depreciation for a property, while the other can receive any tax credits.
- Partnership level debt increases the basis of a partner in his or her partnership interest. Likewise, that increase in a partner's basis increases the amount of total tax losses that the partner may claim. An increased ability to take tax losses is of special importance in real estate ventures, where the depreciation deductions may generate substantial paper losses in connection with distributable cash.

It's for these reasons that this type of arrangement is considered favorable when considering other types of entities.

C-Corporation

A C-Corporation is considered a legal, fictional entity, viewed by the federal government as an imaginary person. A C-Corporation pays taxes as a separate person and incurs liability as a separate person. However, being a separate person can prove to be expensive from a tax standpoint. A C-Corporation pays taxes on its income just like an individual person does, in the following tax brackets:

$0 - $50,000	15%
$51,000 - $75,000	25%
$76,000 - $100,000	34%
$101,000 - $300,000	39%
$301,000 - $10,000,000	34%
$10,000,000 - $15,000,000	35%
$15,000,000 - $18,333,333	39%
$18,333,333 +	35%

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If a C-Corporation distributes money to its shareholders, the shareholders then pay tax on the distribution at their individual rates, which is where the double taxation is applied.

Congress does everything it can to accelerate double taxation of C-Corporation income, and they do this in two ways:

- **Personal Holding Companies:** A closely held C-Corporation that receives 60% or more of its income from interest, rents, royalties, or dividends is deemed to have distributed its earnings for the year to its shareholders and its shareholders are deemed to be in the 40% tax-bracket. Therefore, I do not recommend placing assets that generate rent, interest, royalties, or dividend into a C-Corporation. If you have no choice but to put those assets into a C-Corporation, be sure that the corporation generates at least 41% of its income from active business as opposed to rents and the other income types listed above.

- **Accumulated Earnings Tax:** A C-Corporation that accumulates more than $250,000 must show a reasonable business need for such funds. If that need is not proven, then the funds are deemed distributions and are taxed as if the shareholders were in the 40% tax bracket.

One way to reduce the sting of double taxation is to reduce the corporation's taxable income. A couple strategies for C-Corporations that will aid in doing so are as follows:

- **Pay Salaries to Its Owners:** The salaries will reduce the corporation's overall income, but are taxed at the owner's tax rates and subject to payroll taxes of approximately 15%. If the salaries are viewed as being unreasonably high, the IRS will treat part of the salaries as dividends, which will be subject to double-tax rates.

- **Lease Property from the Owners:** This is better than the salary option. No payroll taxes are paid, and dividends will probably not be reclassified so long as the lease is close to market rates. Closely held corporations should generally lease property from shareholders, as opposed to owning the property outright.

- **Make Loans to the Owners:** The interest rates can be low, allowing for cheap use of money that has not been double-taxed. However, the C-Corporation is making interest income, so one must closely consider the personal holding company rules. As the interest compounds, the amount of money held in the

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C-Corporation grows tax deferred, but is compounding the double-tax issue. In addition, as the interest compounds, the corporation will eventually face accumulated earnings tax issues.

Another important tax related disadvantage of C-Corporations is that they do not get to apply the favorable capital gains rates enjoyed by other entities. All capital gains are thus taxed at ordinary corporate rates.

The tax advantages that C-Corporations do enjoy however are:

- The ability to shift income into lower tax brackets, or income splitting
- Certain prerequisites are tax-free only to C-Corporation employees

S-Corporations

Qualifying corporate shareholders may elect an "S" status when reclassifying their corporation. This election has an effect only for tax purposes; it does not affect the non-tax aspects of a corporation such as liability protection, etc. For federal tax purposes, the election eliminates one layer of taxation. All corporate income is taxed based on the taxpayer's bracket. The corporate income is taxed whether or not the income itself is distributed to the shareholders. When the income is distributed, no further tax is triggered.

In addition to the single layer of taxation, S-Corporations have one other important tax advantage: S-Corporation dividends are exempt from payroll taxes as long as the shareholder-employees are paid a reasonable salary.

The primary disadvantages of S-Corporations include:

- Only human beings and certain trusts may be shareholders;
- No foreigners may be shareholders
- 75 shareholders maximum
- No flexibility; there may be only one class of stock and all rights are prorated based on ownership percentage.

Real Estate Investment Trusts (REIT)

Real Estate Investment Trusts are only suitable for very large real estate operations. Generally speaking, a REIT is simply a C-Corporation that has elected REIT status. REITS are one of the few entity types that can go public and still pay a single

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layer of tax. They can also acquire most types of property tax free in exchange for REIT shares, whether the property is held by partnerships, corporations, or by individuals. The reason that REITS are only suitable for large operations is that they are administratively very expensive. That expense comes as a result of many factors:

- Specialized IRS requirements that REITS must meet such as rental based business, etc.
- Complicated partnership accounting due to the heavy use of partnerships by REITS
- A minimum number of shareholders, 100+, often triggering the numerous and expensive securities laws that apply to public companies.

Limited Partnerships

Limited partnerships are a special breed. Unlike general partnerships, some of the partners do enjoy limited liability. These “limited partners” may not participate in the business of the limited partnership and retain their limited liability. Such partners are considered truly limited. The general partner does not enjoy limited liability, however. For this reason, a C-Corporation is often used as a general partner, so that the individual owners of the C-Corporation are insulated from the limited partnership’s liabilities. As a general rule, the tax treatment of limited partnerships is extremely favorable, identical to that enjoyed by general partnerships.

There are two exceptions, however, to the general partnership tax treatment:

First, limited partners are almost always considered passive investors for tax purposes. Their inability to participate in the affairs of the LP generally keeps them from using losses that are passed through to them to offset active or portfolio income. Therefore, Limited Partnerships are often a bad choice for business ventures that operate at a loss.

Second, in keeping with its passive nature, limited partners’ income from LPs is not subject to payroll taxes. As such, a business generating income that would otherwise be subject to employment taxes may benefit from being categorized as a Limited Partnership.

Limited Liability Companies

For the most part, limited liability companies combine a corporation’s limited liability with the tax treatment of a partnership. In other words, LLCs are viewed as a separate

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person from a liability standpoint but as the same person or persons as its owners from a tax standpoint. It's like having your cake and eating it too. LLCs with one or more members are treated as partnerships for federal income tax purposes, unless their owners elect corporate treatment. LLCs with only one member are ignored with regard to tax purposes, unless that member elects corporate tax treatment. Therefore, multi-member LLCs generally enjoy all of the tax benefits of a partnership without the liability exposure. Likewise, single member LLCs avoid the tax treatment of corporations while also avoiding the liability exposure of a sole proprietor. LLCs offer many options and, in my opinion, the best of both worlds. **LLCs are the entity of choice for my companies and I place each facility I acquire into a separate LLC.** This spreads the risk, and makes it easier to sell since the accounting is dedicated only to the operations of each individual facility. In addition, LLCs haven't been around for very long, which means there isn't a great deal of legal precedence and case law, making it easier to settle any legal disputes that may arise with regard to tax or operations within an LLC.

Trusts

There are three basic variations of a trust with regard to tax purposes:

1. **Grantor Trusts:** Such trusts are usually created by the same person that has a beneficial interest in the trust. These trusts are ignored for federal income tax purposes. Typically, these trusts are set up for the sole purpose of holding title to property. While such a trust provides no liability protection, it does hide the true ownership of the property from the public.

2. **Irrevocable Trusts:** These trusts created with the assets of a grantor, but the beneficial interest passes to someone other than the grantor or his spouse. The grantor effectively relinquishes control over the trust. A separate set of rules applies to such trusts for tax purposes.

3. **Business Trusts:** This is a trust that exists for state law purposes, but it is run as a business for profit. Such trusts are usually treated as partnerships or corporations for federal income tax purposes.

Choosing an Entity

As you see, there are several types of entities that provide identical liability shields for state law purposes. Since that element is basically the same for most of the entities I described, taxation usually drives the choice an investor makes. A summary of what I

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feel are the best choices follows, given different objectives and types of business:

Investor Properties Producing Taxable Income and/or Gains

- In my opinion, an LLC is the best choice. Gains can be passed through to members without double taxation. The partnership itself can be structured in any number of ways. Properties may be distributed tax free and used for 1031 exchanges. Favorable capital gains rates are preserved and passed through to owners. LLCs also provide superior estate planning opportunities.
- LP's will produce the same result, but the need for a corporate general partner adds complexity and expense. In states where LLCs are much more expensive than LPs, it may be more advantageous to use the LP rather than the LLC.
- In businesses where limited liability is of most importance or when selling shares on the open market, it is recommended to use the LP as it has a longer track record and it is more familiar to institutional investors.
- In states where both LLCs and LPs are extremely expensive, it may be advantageous to form an S-Corporation. However, this should only be considered if it is far too cost prohibitive as this is not the preferred structure for buying and holding properties compared to LLCs and LPs.

Investor Properties Producing Tax Losses

- Again, I prefer the LLC for the same reasons presented above.
- S Corporations and LP's provide roughly the same benefits for loss generating long term keepers. The LP allows for somewhat larger losses than the S Corporation where you are leveraging the property. In contrast, passive loss limits are generally easier to avoid with S-Corporations than with LP's. The decision depends upon the details of the property and the taxpayer's individual situation.

C-Corporations?

As you can see, I don't normally recommend C-Corporations for holding or selling real estate. They rarely make sense for buy and hold investors, though they occasionally make sense for smaller flips. As I mentioned above, choosing a C-Corporation depends upon a number of different factors with regard to the taxpayer and his or her operations. One situation where a C-Corporation makes sense is where the investor has properties that require management and/or rehabilitation. A C-Corporation can be created to provide the services, and use the tax favored perquisites and income splitting features. One advantage of such a captive company is that the amount of income that it earns can be

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controlled. Thus, the owners can ensure that the C-Corporation makes enough to provide the desired perquisites and income splitting without making enough to trigger double taxation.

Trusts

Grantor trusts are typically used to conceal the ownership of a property from prying eyes. For example:

John wishes to purchase an office building where he can meet friends, business associates, etc. He does not want his wife to find out about the building. John sets up the "friends of John" trust and asks his business associate, Frank, to act as Trustee. Frank's only power as trustee is to hold title to the Building. John is the beneficial owner of the trust, has full use of the building and can direct Frank to change the title of the building. John pays for the building and the name on the title reads "Frank as Trustee for the friends of John trust". The trust agreement is the only evidence of John's ownership and control over the building. Because the trust agreement is not a public document, there is no public information linking John to the building. The trust is completely ignored for federal income tax purposes because it is a grantor trust. From a tax standpoint, John is the direct owner. In most states, the trust does not protect John from liability that relates to the building; it merely conceals his ownership of the building from the public view.

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CHAPTER 16

Asset Protection

Scott Meyers

Asset Protection is a vast subject to discuss. There are many books written on the subject and it is based on each individual's exact circumstances. However, several generalizations with regard to commercial real estate may apply:

Plan Now: Do not wait until you think you may be in trouble to begin planning for your protection. In the event that you do find yourself in a pickle, transferring property into other entities in an effort to conceal your holdings can be considered "fraudulent conveyance", and can land you in deeper trouble with the courts. **Don't procrastinate, do it now!**

You can't overdo it: Many critics argue that asset protection is somehow unethical. I strongly disagree, and suggest you dismiss any advice to the contrary. There are people out there who can and will take your properties if they feel as if they can. Plaintiffs' attorneys are ruthless and will not blink an eye when bankrupting a business owner in an effort to turn a profit or get their name in the papers. Your opposition plays for keeps, and they have sufficient backing and knowledge of how to bring you down if they feel they are in the right. **Find yourself a good attorney who is adept at Asset Protection, and let them know that you have no intention of letting someone take away what you have spent years and a great deal of money and effort to build.**

Be Honest: I know this probably goes without saying, but it never ceases to amaze me at how many people out there feel as if the only way to get ahead in this game is to lie or misrepresent the facts. Courts will go out of their way to punish liars by piercing the corporate veil, any trusts, and going after their insurance company to make a point. An angry judge will stop at nothing if he feels the defendant has intentionally misrepresented

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himself or his property in a transaction. **So, the simple rule here is to be honest, and be fair.**

Avoid Fraud: Again, I'm not making any accusations as I am a firm believer that all people that I enter into a transaction with can be trusted. But I have also been on the receiving end of a seller who has misrepresented their property, and it has cost me dearly. So, I'll be realistic here in the text, and discuss the penalty for committing fraud, including the appearance of fraud. Make sure that you are straight up in fact and in appearance. I assume that everything I say or do could be scrutinized by a hostile audience should a transaction go south in the future. Build yourself a reputation for honesty and fairness; be firm without being a jerk. These qualities are overlooked by many investors in the marketplace and I feel are a crucial part of asset protection.

Educate your Employees: Employees can unknowingly cause you a lot of grief. There are many laws that pertain to discrimination, harassment, etc. in the rental of units, even in self storage. If they commit an error, and you were personally negligent in hiring and training them, you may be personally liable for their actions. **Be certain that your employees are aware of what they can and cannot say and do in the day-to-day operations of your facility.**

Insurance: I prefer to buy insurance from the larger players in the industry through the nation's largest broker for Self Storage insurance, who just so happens to be located in my home town of Indianapolis. I know these companies can handle claims, and they have, and will be in the marketplace for the foreseeable future. I tend to have long meetings with my agent when we buy another facility to be certain that I know exactly what is and is not covered. Also, **I am certain not to under-insure myself.** If your liability maxes out at $1,000,000, and someone wins a lawsuit against you for $1,500,000, guess what, you need to personally make up for the shortfall.

Document, Document, Document: When an attorney knocks on the door and is planning to take your facility away, documentation will be the key to saving it. **If you don't have documentation, everything said is your word against theirs.** Don't put yourself in this unenviable and extremely vulnerable position. Carefully documenting your relationship with contractors, sellers, buyers, agents, professionals, and anyone else with whom you do business with is your first line of defense. If you have careful documentation, many would be agitators may back off. For those tenacious in pursuing their claims in court most often lose against well prepared adversaries. **If it's not written, it didn't happen, so write it down and file it away.**

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Land Trusts: You can use Land Trusts to conceal your company's ownership of assets. These trusts also facilitate the sale of assets without incurring transfer taxes. In addition, selling the beneficial interest in a Land Trust results in the sale of the facility itself, but may avoid the local transfer taxes that would apply upon the direct sale of the facility.

Separate your Assets: As mentioned above, I keep all my facilities in separate LLCs. Some Investors will also segregate high liability operations such as management companies, or construction companies, from the lower liability assets, the self storage facilities themselves. Given that storage facilities are relatively large, a separate entity per property is appropriate for bookkeeping, asset protection, and a host of other benefits. Be certain to select the appropriate entity type from our previous discussion.

Find ~~Good~~ Great Advisors: This discussion on Asset Protection has been very brief, and is framed to simply make you aware that **you need to seek great advisors to discuss how to operate your business.** Asset Protection is custom made, so if you haven't done so, please seek a qualified, and highly recommended advisor to tailor make your protection plan sooner rather than later. It has been said that there are at least two people in your life that you should probably consider paying top dollar for: your Doctor, and your Attorney. Personally, I couldn't agree more.

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Self Storage Profits Inc.

Self storage Acquisitions

A Step by step system for creating wealth in self storage

CHAPTER 17

Take Action

Scott Meyers

Scott's Five Principles of Success

The central focus of this home study course is to arm you with the specific tools necessary to identify potential acquisition candidates, to acquire and manage those facilities once you have identified them, to implement sound techniques for creating value, and finally, to capture all of that value through various exit strategies. The process by which all of this can be accomplished rests on five keys that I feel are crucial to success. These keys do not deal with the mechanical processes involved in buying and selling self storage facilities, but are grounded in principles that are fundamental to life itself. These laws deal with the human psyche and govern our thoughts, which in turn, direct our actions. The failure to understand these keys, which have proven to provide the foundation for success, will almost certainly result in your defeat.

Principle # 1 – Overcome Fear of Failure

Probably the greatest obstacle to getting started in any business venture is that demon we call FEAR. Just as we have to include risk in our equation of success, so must we include fear. This is not to say that we have to fail first to become successful, rather we must acknowledge that the possibility of failure exists. Failure is a natural part of learning, and as crazy as it sounds, I am extremely thankful for the MANY failures I have endured over my real estate investment career. It is a completely natural process, and just because you fail, doesn't mean you are a failure. Unfortunately, however, I have seen many people that have been defeated by the *fear* of failure. Some don't even make it to the failure stage because they were too afraid to try; they were afraid of failing. Some

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people fear the unknown because it represents areas beyond the boundaries of their comfort zone. Mostly, they fear what others may think of them! They fear ridicule by their friends, and even worse, ridicule by their own families. This fear has stopped more would be successful investors than all other factors or considerations combined.

Some friends act as an anchor placed around your shoulders, holding you firmly in place, keeping you from reaching your true potential. I have done my best to surround myself will people who act as buoys, who lift me up, rather than hold me down. I am more selective in whom I spend time with as I grow older, choosing to spend time with people who have a similar, positive approach they take to work while glorifying God with the time they spend on his earth. As your friends and your family witness your progress, eventually, their attitudes will change, and you may even discover that they will probably start coming to you for advice from time to time.

Principle # 2 – Setting Goals

A BHAG's (or Big Hairy Audacious Goal) is defined by Jim Collins in his books "Good to Great" and "Built to Last", as a huge and daunting goal-like a big mountain to climb. It is clear, compelling, and people "get it" right away. A BHAG serves as a unifying focal point of effort that keeps you striving toward a pre-defined finish line. I would compare it to the 1960s NASA moon mission where President Kennedy's goal of reaching the moon captured the country's imagination and grabbed people in the gut. Your BHAG should be quantifiable and possess some timeframe associated with it. Jim Collins went on to describe The Five Criteria of a good BHAG as follows:

1. Are set with understanding, not bravado.
2. Fit within the parameters of what you are deeply passionate about, what you can be the best in the world at, and what drives the economic engine of your company.
3. Have a long-time frame—10 to 30 years.
4. Are clear, compelling and easy to grasp.
5. Directly reflect your core values and core purpose.

It is much easier to become a great organization than to remain a great organization over time. To remain great over time requires, staying focused on what you are deeply passionate about, what you do the best, and what is most profitable in your investing career.

For me and my company, my clear and quantifiable BHAG is to reach 1,000,000 square feet within 5 years. This will allow my organization to be elevated to a place in the industry that opens up a whole new world of opportunities with regard to lending, vendor discounts,

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and status within the various trade associations. However, this is not at the expense of compromising my core values and purpose, which are intertwined with my BHAG and communicated to every member of my organization.

Principle #3 - Establishing Priorities

Setting Goals however, doesn't do you or your organization any good without a game plan in place to achieve them. This starts with prioritizing your activities on a daily, weekly, monthly, and yearly basis to ultimately conquer your BHAG. John D. Rockefeller, the founder of Standard oil who went on to build one of our country's most successful organizations, was a master at prioritizing the activities of his firm to ensure that it attained his goals. After studying his biography "*Titan*" by Ron Chernow, I was compelled to adopt his principles of prioritizing my activities by breaking them down into different levels. I have now established the top 5 priorities for the year and quarter and a clear top 1 priority along with an appropriate Theme. Beyond that, everyone in my organization has their own handful of priorities that align with my firm's top priority. To reinforce this and to ensure we're all rowing in the same direction, I review our company data on a daily and weekly basis to verify each team member's performance. I also conduct weekly meetings to maintain alignment with our goals and to drive accountability.

Remember, if it isn't written down and measured, it doesn't get done.

These priorities change from year to year, but as an example, we recently set a priority to keep collections below 5% beyond 30 days across all our properties. The manager's report on this weekly and at our meetings we strategize and share ideas and best practices that the managers have used to successfully reach their goals.

Principle # 4 – Perseverance

The will to persevere is not only crucial to one's success in the real estate investment industry; it is crucial for success in all aspects of one's life. The ability to endure whatever challenges life throws at you is essential for personal development and growth, and it is especially true for the attainment of wealth. **If you wish to accumulate wealth, then you must be willing to dedicate a great deal of effort to that end.** Creating wealth by building a self storage empire is just like any other skill you choose to master. It takes persistence, patience, and the will to persevere.

Think of a skill that you are particularly adept at. Whatever that skill is, if you are like most people, you have honed and developed that skill over the years and you now possess it as the result of your dedication and the will to excel in your chosen field. In other words,

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it wasn't handed to you; nothing in life worth having is. A good illustration is that kid we all knew in school whose parents gave him or her everything they wanted. Remember the way they took care of what was handed to them? I remember a friend of mine who didn't care if he broke his toys, left his bikes out in the yard, and eventually destroyed every car he ever owned because he knew it would always be replaced by his parents. Eventually, these kids grow into irresponsible adults who lack crucial skills necessary to not only navigate life, but rarely do they learn what it takes to accumulate wealth.

Perseverance is a conditioning process that is best learned in our youth. Perhaps, like me, you have been conditioned by your environment in your formative years. Family and friends have told you that "you cannot do it; you don't have what it takes; that's a risky idea; or I know someone who tried that and failed miserably".

This continual negative assault may have slowed or halted your progress. Perhaps some of your past attempts did fail, bruising your ego, and you began to believe what the naysayers were throwing at you. I know some people who were in this same situation, and to alleviate the pain, they just gave up. It was too hard for them to see through the darkness and trust that things were going to turn around, and that success was not as far away as they had thought. **In order to persevere, you must recognize that the short term sacrifices you endure now will be well worth the long-term benefits you will eventually enjoy**.

After all, they say Thomas Edison experimented with over 6,000 different materials before he was able to find a suitable filament for the light bulb. And in the often-quoted words of Winston Churchill to Great Britain when it seemed that all hope was lost and the Germans were invading his country and threatening to overthrow him, "Never, Ever Give in"!

Principle # 5 - Developing your Purpose

I firmly believe that it is just as important to know why you are going on this journey as it is to know where you are going on the journey. And on a more philosophical level, you may be asking yourself, what is my purpose in life? What exactly is it that I hope to achieve in this process of wealth accumulation, and **what do I plan to do once I have achieved my goals?** The answer will be different for everyone, and may take some genuine reflection and or prayer to find the answer. For me, my ultimate goal was to "build a business that would provide enough cash flow to meet my financial needs both today, and the future, and allow a great deal of free time to serve God, and be with my family without having to be overly active in the day to day operations of those businesses". I have been extremely blessed to edge ever closer to achieving that goal and I am beginning to reap the rewards after many years of following my plan. One such benefits

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is having enough time to write this home study course in an effort to help others, and to give of myself as so many people have given to me.

The challenges of wealth accumulation challenges one to grow in ways you never thought possible. It provides a bridge to a higher plane in life by empowering you to reach your full potential. Wealth enables you to enrich the lives of those around you who may not be as fortunate for any number of reasons. I believe that purpose is much greater than to amass riches simply for the sake of serving myself. Once you are fortunate enough to have achieved your objectives, much happiness lies in the giving of yourself and of that which you have attained through your labors. I believe that God gives me what will flow through me and that if I honor him as the steward of the business which he has entrusted to me, then he will enrich me knowing that I will pass those blessings along to others. This sense of purpose gives me hope, every day, for a higher quality of life, and hope to someday ease the pain of those with heavy burdens.

A sense of purpose can help us to defeat the demons we call Fear and Despair. A sense of purpose can act as a compass by showing us the way when we are confronted with these challenges and providing us direction. I refuse to settle for a life of mediocrity, or succumb to fear, or whatever enemy that happens to obstruct my path to success. And for those of you who believe that perhaps it is too late, I invite you to draw from Napoleon Hill's classic book, *Think and Grow Rich:*

> *Seldom does an individual enter upon highly creative effort in any field of endeavor before the age of forty. The average man reaches the period of his greatest capacity to create between forty and sixty. These statements are based upon analysis of thousands of men and women who have carefully been observed. They should be encouraging to those who become frightened at the approach of "old age", around the forty-year mark. The years between forty and fifty are, as a rule, the most fruitful. Man should approach this age, not with fear and trembling, but with hope and eager anticipation. (Page 190)*

If you are between 40 and 60, I am sure you take great comfort in Hill's remarks. This represents a period of time when you can fully apply yourself. It is a time when you can embark on the greatest journey of your life – the pursuit of a higher quality of life through the accumulation of wealth.

The laws for success in the self storage industry have been outlined in the pages of this home study course. It describes the merits of numerous financial concepts and principles

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that, when properly applied, will enable you to attain your goal of accumulating wealth. In addition, it provides you with the precepts necessary to master the human psyche, that element of our being that gives us the strength to persevere and to conquer our fears, gives us the wisdom to accept responsibility for our actions, and gives us direction in our lives by providing us with a sense of purpose. It is the combination of these laws of success serve as the catalyst you can apply to propel yourself to heights you may have never before believed possible. And to quote Donald Trump in his book *The Art of the Deal,* “*if I’m going to be thinking anyway, I might as well think Big”!* I couldn’t agree more.

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Case Study

Brownsburg Crossing Self Storage

650 N. Dale Schrier Dr.
Brownsburg, IN 46112

Prepared for:

Self Storage Profits, INC.

By: Scott Meyers CSSM
Alcatraz Storage

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SELF STORAGE
INVESTING

September, 2007

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Executive Summary

The purpose of this case study is to provide an overview of the acquisition of The Brownsburg Crossing Self Storage Facility in Brownsburg, Indiana.

The site is presently owned by Alcatraz Storage™, a Fishers, Indiana based national self storage development and ownership company.

Alcatraz Storage purchased this facility from the original owner/developer who built the facility in 1994. The developer sold a portion of the business to an investment group who operated the facility for a short time, with joint ownership.

The ownership and management of Alcatraz Storage™, LLC felt this acquisition presented a truly exceptional investment opportunity, and ultimately purchased the facility in August of 2007.

The property's location adjacent to the south side of I-74, and ¼ mile from the nation's largest, and fastest growing motor sports park, in addition to 2 new residential subdivisions, made this a very attractive opportunity.

Salient Features

High Density of Population	125,789 residents 17,543 within 3 miles
High Ratio of Renter Occupied Housing	75.7% 1 mile Radius
High Ratio of Commercial Based	
Clientele	+ 38%
Purchase Price	$1,800,000
Owner Contribution	**$0**
Loan Amount	$1,440,000 First Mortgage $360,000 Seller Carry Back 2nd mortg.
Year Built	1994
Land Size	4.00 Acres

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Total Rent Spaces	178
Net Rentable Square Footage	26,100
Percentage of Climate Climate Control	± 13%

Brownsburg Crossing Prospect Fact Sheet

I found this property on Loopnet (www.loopnet.com) and contacted the broker for the information you see below. Although his offering sheet contained most of the important facts, there are several others I need to know before moving forward. Below is a copy of the actual fact sheet I used in determining whether to pursue this opportunity.

Alcatraz Storage Prospect Fact Sheet

Name of Business ***Brownsburg Crossing Self Storage***
Owner Name ***Kent and Brian***
Phone # ***317-858-3158*** Fax # ***317-858-2111***
Email Address ***N/A*** Website ***BrownsburgCrossingSelfStorage.com***
Address of property ***650 N. Dale Schrier Dr. Brownsburg, IN 46112***
Main St? ***NO*** Construction ***Brick/Steel*** Gate ***Electronic*** Software ***Digigate***
Sq.ft. ***26,100*** # of units ***270*** Occupancy ***80%*** Gravel/Paved ***Gravel***

Fenced ***Yes*** Security ***Yes*** # of Bldgs ***5*** Age ***1994***

Acres ***4.0*** Vacant land ***Yes*** Boat/Rv Parking ***Yes*** Truck Rental ***No***
Competition ***Yes, several within 5 miles, but not much on RV/Climate Control***
Gross Rent ***$218,484*** Other Income(U-haul, pack/ship) ***No***
Property Taxes ***$15,600***
Insurance ***$4,800***
Utilities ***$9,360***
Repairs/Maintenance ***$2,400***
Advertising ***$1,008***
Management ***$10,400***
NOI ***$174,916 (negotiated and purchased for $1,775,000 for a 10% Cap Rate)***
Who handles the Management ***Onsite PM*** Office on site ***Yes***
Population ***17,543 within 3 miles*** Growth ***yes, 3.5% per year***
Why are you looking to sell? ***Got in an exchange, don't like the SS business***

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How much are you willing to sell for? ***$1,800,000*** Willing to carry back a second mortgage? ***Yes!***
Current Mortgage Holder ***Citizens Bank***

Well as you can imagine, at a 10% cap rate, room to expand, and with a seller willing to carry back a second mortgage, I very quickly set an appointment to tour the property. The broker had several other parties interested, so I arrived at the facility with a purchase agreement already filled out. I toured the property with the Broker, and quickly realized that this was a property that fit my investment objectives. We went back into the office, looked over the rest of the offering summary, **and I wrote an offer on the spot**. I felt no need to put in a low-ball offer that would be rejected, or give them a chance to accept another offer while we were haggling over price. **I wanted to be sure to tie this property up before my competition beat me to it.** The listing price was $1,899,000, and I placed an offer for $1,800,000, a price the broker agreed would probably be accepted. A copy of my purchase agreement is included below: (a sample of the purchase agreement is included in the appendix, and a on the enclosed forms CD)

PURCHASE AGREEMENT

COMMERCIAL-INDUSTRIAL REAL ESTATE

Date: June 11, 2007

A. **PARTIES: Brownsburg Crossing Self Storage ("Seller")** agrees to sell and convey to **The Brigadier, LLC and or assigns ("Buyer")** and Buyer agrees to buy from Seller the following property for the consideration and subject to the following:

   PROPERTY: The property is commonly known as **Brownsburg Crossing Self Storage, more commonly known as 650 N. Dale Schrier Drive, Brownsburg, IN 46112**, including all buildings and permanent improvements and fixtures attached; all privileges, easements and appurtenances pertaining thereto including any right, title and interest of Seller in and to adjacent streets, alleys, rights-of-way, leases, rents, security deposits, licenses and permits with respect to the property, trade name, and warranties or guaranties relating to the property being sold, and any personal property, furniture, fixtures and equipment used for the daily operation of the Property to be specified within ten (10) days of acceptance of this Purchase Agreement on a separate Exhibit “A” and as agreed to by Seller and Buyer; all of the above referred to as the "Property," the legal description of which is to be provide later by survey.

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B. **PRICE:** The purchase price shall be **One Million, Eight Hundred Thousand Dollars ($1,800,000.00), One Million Four Hundred Forty Thousand dollars ($1,440,000,000) to be paid in cash at closing. Seller will be carrying back a 2nd mortgage on the property for the remaining amount of Three Hundred Sixty Thousand dollars ($360,000) secured by a note and mortgage at 7.25% interest, amortized over 30 years, to be paid in full within 36 months of the closing date. The 2nd mortgage Carrier will be listed and referenced in Attachment B of this Purchase Agreement. Buyer to provide a personal financial statement to Seller prior to signing to confirm Buyer has sufficient net worth to protect carry-back. Buyer also to sign Personal Guaranty of carry-back loan.**

C. **EARNEST MONEY:** Buyer submits **Five Thousand Dollars ($5,000.00)** as Earnest Money to be held by **Abstract & Title Company, Tammy Fleece or Ben Comer** as Escrow Agent, upon execution of this Agreement by both parties. The Earnest Money shall be applied to the purchase price at closing unless returned to Buyer, released to Seller, or otherwise disbursed in accordance with this Agreement. The Escrow Agent is not a party to this Agreement and does not assume or have any liability for performance or non-performance of any party. Before the Escrow Agent has any obligation to disburse the Earnest Money in the event of dispute, Escrow Agent has the right to require from all parties a written release of liability of the Escrow Agent, termination of the Agreement and authorization or court order to disburse the Earnest Money.

D. **CONDITIONS OF SALE**: (1.) Buyer shall have Forty-Five (45) days to obtain financing form a third-party lender for Eighty Percent (80%) of the Price and subject to terms and conditions that in Buyer's sole opinion are acceptable. (2.) This Purchase Agreement is subject to the attached Leased Property Addendum. (3.) Seller shall provide buyer a coaching period of up to 30 days to assist Buyer in transitioning to the Property as the new Owner.

E. **CLOSING:** The closing of the sale shall take place at Abstract & Title Insurance Company on or before **August 31, 2007** unless the Closing Date is changed in writing by Seller and Buyer, or otherwise extended pursuant to this Agreement.

F. **POSSESSION:** The possession of the Property shall be delivered to Buyer, subject to the rights of tenants in possession, in its present condition, ordinary wear and tear excepted, **at closing**. Seller shall maintain the Property, including fixtures, equipment and any personal property until possession is delivered to

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Buyer.

G. **REAL ESTATE TAXES:**

1. **Current Year (Lien Basis) Proration:** The taxes assessed for the current year, due and payable in the year following closing shall be prorated between Seller and Buyer on a calendar year basis as of the day immediately prior to the Closing Date. All taxes assessed for any prior calendar year and remaining unpaid shall also be paid by Seller.

For Purposes of G.1. above:

a. If the tax rate or assessment for taxes assessed or payable in the year of closing has not been determined as of the Closing Date, the assessment or rate shall be assumed to be the same as the most recent assessment or rate.
b. Taxes which are Seller's responsibility and not yet due as of the Closing Date shall be credited against the purchase price or cash portion thereof payable by Buyer at closing, and Seller shall have no further liability for such taxes.
c. All taxes due and payable on or prior to the Closing Date shall be paid at or before closing and charged at closing to the responsible party.

(NOTE: The succeeding year's tax bill for recently constructed buildings or following reassessment periods may greatly exceed the last tax bill available to the closing agent.)

H. **INSURANCE AND RISK OF LOSS:** Seller shall maintain replacement cost (if available) or actual cash value "all risk" insurance on the Property through the Closing Date. Seller's insurance shall be canceled as of the Closing Date and Buyer shall provide its own insurance thereafter. Risk of loss by damage or destruction to the Property prior to the closing shall be borne by Seller. In the event any damage or destruction is not fully repaired prior to closing, Buyer, at its option, may either terminate this Agreement or elect to close the transaction, in which event Seller's right to all insurance proceeds not yet applied to repair of the damage or destruction shall be assigned in writing by Seller to Buyer at closing.

I. **CONDITIONS TO CLOSING:** Buyer's obligations under this Agreement are conditioned upon satisfaction of each of the following items which are for the

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Buyer's benefit and may be waived by Buyer at Buyer's sole discretion.

1. **Title Commitment:** A commitment for title insurance (the 'Commitment") issued by a reputable marketable title in Seller's name shall be **ordered by Seller, at Seller's expense** promptly upon acceptance of this Agreement and shall be delivered to Buyer within **10 days** after acceptance of Purchase Agreement. At Buyer's request, legible copies of all recorded instruments affecting the Property or recited, as exceptions in the Commitment shall also be delivered. Buyer to pay for all title endorsements

2. **Survey: A survey shall be ordered by Buyer, at Buyer's expense, immediately upon Buyer receiving conditional approval and Buyer providing written evidence of the same to Seller of the required financing outlined in Item "D. (1.)". A conditional approval shall mean a lender has approved the Buyer's financial capacity to purchase the Property subject to an appraisal of the Property and final approval of the lender's loan committee. The survey shall be delivered to Buyer within 30 days after being ordered.** Prepared by a licensed Indiana survey or selected or approved by Buyer, shall comply with Minimum Standard Detail Requirements for American Land Title Surveys, including optional requirements, shall reflect whether the Property is located in a designated flood zone area and shall be certified to Buyer, the Title Company and Buyer's lender.

3. **Title and Survey Approval:** If Buyer has an objection to items disclosed in the Commitment or the survey, Buyer shall make written objections to Seller within **10 days** after receipt of both the Commitment and Survey. Upon the expiration of such period, any item not objected to by Buyer or subsequently approved by Buyer in writing shall be deemed a permitted exception ("Permitted Exception"). If Buyer makes objections, Seller shall have **thirty (30) days** from the date the objections are made to cure the same, and the Closing Date shall be extended, if necessary. Seller agrees to utilize its best efforts and reasonable diligence to cure any objections, but only to the extent necessary to convey marketable title. If the objections are not satisfied within the time period, Buyer may either terminate this Agreement and receive a refund of the Earnest Money or waive the unsatisfied objections and close the transaction.

4. **Inspections:** Buyer shall have determined that the Property has no unacceptable, adverse environmental or physical condition as provided

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below.

a. **Environmental Assessment: A Phase I environmental site assessment of the property May be ordered by the Buyer promptly upon loan approval at Buyer's expense should the lender require it.** The Phase I shall be conducted in Accordance with ASTM standards unless otherwise agreed and may also include a Buyer's option the following matters:

1) An investigation for the presence of asbestos, radon, lead or polychlorinated biphenyls (PCBs) on the Property; and/or
2) An investigation to determine if the Property is located in any regulated or protected area under the jurisdiction of the U.S. Army Corps of Engineers, the U.S. Environmental Protection Agency, the Indiana Department of Environmental Management, the Indiana Department of Natural Resources, the U.S. Fish and Wildlife Service or any other federal, state or local agency.

If Buyer does not make a written objection to any problem(s) revealed in the report within **10 days** of receipt of final written report, the Property shall be deemed to be acceptable. If Buyer determines that the environmental condition is unsatisfactory, Seller shall have a reasonable period of time, not to exceed **30 days**, to remediate the condition to Buyer's satisfaction and the Closing Date shall be extended, if necessary. If Seller fails or refuses to remediate, Buyer may either terminate this Agreement and receive a refund of the Earnest Money or waive its objection and close the transaction.

b. **Physical Inspections:** Promptly upon acceptance of this Agreement, all physical inspections shall be ordered at **Buyer's expense** and must be delivered to Buyer within **21 days** after acceptance of Purchase Agreement. Qualified inspectors or contractors selected or approved by Buyer, with written reports delivered to Seller and Buyer shall make inspections. Inspections may include but are not limited to the following: heating, cooling, electrical, plumbing, roof, walls, ceilings, floors, foundation, basement, crawl space, water, storm and waste sewer, well/septic and geotechnical. If Buyer, in its reasonable discretion, believes that an inspection report reveals a major defect in or with the Property, Buyer shall report such defect in writing to Seller within days of If Buyer does not make a written objection to any problem(s) revealed in the report(s) within such time period,

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the Property shall be deemed acceptable to Buyer. Seller shall have a reasonable period of time, not to exceed **30 days**, to repair any such major defect to Buyer's reasonable satisfaction and the Closing Date shall be extended, if necessary. If Seller fails or refuses to repair, Buyer may either terminate this Agreement and receive a refund of the Earnest Money or waive its objection and close the transaction. Buyer and its agents shall have the right to enter the Property upon reasonable advance notice and make all inspections provided for herein. Buyer shall restore any damage to the Property resulting from the entry of Buyer or its agents and shall indemnify, defend and hold harmless Seller as to any injury to persons or damage to their property resulting from the acts or omissions of Buyer or its agents in conducting their activities on the Property.

J. **PRORATIONS AND SPECIAL ASSESSMENTS:** Interest on any debt assumed or taken subject to, any rents, all other income and ordinary operating expenses of the Property, including but not limited to, public utility charges, shall be prorated as of the day prior to the Closing Date. Any special assessments applicable to the Property for municipal improvements made to benefit the Property prior to the date of acceptance of this Agreement shall be paid by Seller at or before closing. At closing, Buyer will assume and agree to pay all special assessments for municipal improvements, which are completed after acceptance of this Agreement.

K. **SALES EXPENSES:** All sales expenses are to be paid in cash prior to or at the closing.

1. **Seller's Expenses**: Seller shall pay all costs of releasing existing loans and recording the releases, ½ of closing fees, preparation of Deed and Vendor's Affidavit, Indiana Gross Income Tax, and other expenses stipulated to be paid by Seller under other provisions of this Agreement.

2. **Buyer's Expenses**: Buyer shall pay all expenses incident to any new or assumed loan, ½ of closing fees, and expenses stipulated to be paid by Buyer under other provisions of this Agreement.

L. **DEFAULT:** If Buyer breaches this Agreement, Seller may seek any remedy provided by law or equity, or terminate this Agreement and receive the Earnest Money as liquidated damages. If Seller breaches this Agreement, Buyer may terminate this Agreement and receive a refund of the Earnest Money, or Buyer may seek specific performance or any other remedy provided by law or equity.

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M. **DUTIES OF BUYER AND SELLER AT CLOSING:**

1. At the closing, Seller shall deliver to Buyer, at Seller's sole cost and expense, the following:

   a. A duly executed and acknowledged **General Warranty Deed** conveying marketable title in fee simple to all of the Property, free and clear of any and all liens, encumbrances, conditions, easements, assessments, reservations and restrictions, except Permitted Exception(s);
   b. An Owner's Policy of Title Insurance (the "Title Policy") issued by the Title Company in the amount of the purchase price, dated as of closing, insuring Buyer's fee simple title to the Property to be marketable subject only to the Permitted Exception(s), and deleting the standard printed exceptions contained in the usual form of the Title Policy;
   c. An executed Vendor's Affidavit in form acceptable to the Title Company;
   d. A Bill of Sale, duly executed by Seller, containing warranties of title, conveying title, free and clear of all liens, to any personal property specified in Paragraph B;
   e. An assignment, duly executed by Seller, of leases, prepaid rents, security deposits, and trade name, and to the extent assignable, licenses and permits, warranties or guarantees, and to the extent agreed to be assumed by Buyer, all service, maintenance, management or other contracts relating to the ownership or operation of the Property. Such assignment shall include an indemnity from Seller in favor of Buyer with respect to all claims and obligations arising under such leases and contracts prior to the Closing Date. Buyer must accept assignment of all leases.
   f. A current rent roll duly certified by Seller and any security or tenant deposits, if applicable;
   g. Evidence of its capacity and authority for the closing of this transaction;
   h. Certification establishing that no federal income tax is required to be withheld under the Foreign Investment and Real Property Tax Act, or consent to withhold tax from the proceeds of sale as required, unless it is established that the transaction is exempt;
   i. All other executed documents necessary to close this transaction.

2. At the closing, Buyer shall perform, at Buyer's sole cost and expense, the following:

   a. Pay the cash portion of the purchase price in the form of a cashier's check or other immediately available funds;

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b. Execute any note(s) and mortgage(s), personal guaranty, and any other documents, and cause the funds to be made available to the closing agent for disbursement;
c. Provide evidence of its capacity and authority for the closing of this transaction;
d. Provide to Buyer's lender any title policy as required by the holder(s) of the mortgage(s), and be responsible for the cost of endorsements;
e. Execute all other documents necessary to close this transaction.

N. **CONDEMNATION:** Seller shall promptly notify Buyer in writing of the commencement of any condemnation proceedings against any portion of the Property. If such condemnation proceedings are commenced, Buyer, at its option, may (1) terminate this Agreement by written notice to Seller within **10 days** after Buyer is advised of the commencement of condemnation proceedings, or (2) appear and defend in any condemnation proceedings, and any award shall, at Buyer's election, (a) become the property of Seller and reduce the purchase price by the same amount or (b) shall become the property of Buyer and the purchase price shall not be reduced.

O. **RESPONSIBLE PROPERTY TRANSFER LAW:**

1. Seller is not required to provide Buyer with a Disclosure Statement pursuant to I.C. Section 13-25-3-1 et seq., Indiana's Responsible Property Transfer Law ("IRPTL"), because, to the best of Seller's knowledge, the Property is exempt from the provisions of the law or (a) the Property does not contain any hazardous chemical or material; (b) the Property does not contain any underground storage tanks which are or have been utilized to hold petroleum or other regulated substances; and (c) the Property is not listed on the Comprehensive Environmental Response, Compensation and Liability Information System.
2. If Seller learns that the Property comes within the terms of IRPTL after execution of this Agreement, then Seller shall provide to Buyer the required disclosure document and comply with all other parts of this law.

P. **MISCELLLANEOUS:**

1. Any notice required or permitted to be delivered shall be deemed received when personally delivered or when confirmed as received by facsimile, express courier or United States mail (postage prepaid, certified and return receipt

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requested) addressed to Seller or Buyer or their designee at the address set forth below the signature of each party.

2. This Agreement shall be construed in accordance with the laws of the State of Indiana.
3. Time is of the essence. Time periods specified in this Agreement and any addenda are calendar days and shall expire at midnight of the date stated unless the parties agree otherwise in writing.
4. This Agreement is binding upon and for the benefit of the parties' respective heirs, Administrators, executors, legal representatives, successors, and assigns. No assignment of this Agreement shall release a party from liability for its obligations hereunder.
5. If any provision contained in this Agreement is held invalid, illegal, or unenforceable in any respect, the invalidity, illegality, or unenforceability shall not affect any other provision.
6. This Agreement constitutes the entire agreement of the parties and cannot be changed except by their written consent.
7. By signing below, the parties to this transaction acknowledge receipt of a copy of this Agreement and give their permission to a Multiple Listing Service or other advertising media, if any, to publish information regarding this transaction.
8. Any party who is the prevailing party against any other party in any legal or equitable proceeding relating to this Agreement shall be entitled to recover court costs and reasonable attorney fees from the non-prevailing party.
9. The parties agree that this Agreement may be transmitted between them by facsimile machine. The parties intend that faxed signatures constitute original signatures and are binding on the parties. The original document shall be promptly executed and/or delivered, if requested. This Agreement may be executed simultaneously or in two or more counterparts, each of which shall be deemed an original, but all of which together shall constitute one and the same instrument.
10. Each person executing this Agreement on behalf of a party represents and warrants that he or she has been authorized by all necessary action to execute and deliver this Agreement on behalf of such party.

Q. **CONSULT YOUR ADVISORS:** Buyer and Seller acknowledge they have been advised that, prior to signing this document, they should seek the advice of an attorney for the legal or tax consequences of this document and the transaction to which it relates. In any real estate transaction, it is recommended that you consult with a professional, such as a civil engineer, environmental engineer, or other person, with experience-in evaluating the condition-of the property, including the

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'possible presence of asbestos, hazardous and/or toxic materials and underground storage tanks.

R. **TERMINATION OF OFFER:** Unless accepted by Seller and delivered to Buyer by **5:00 P.M., the 12th day of June 2007**, this Purchase Agreement shall be null and void and all parties shall be released of any and all liability or obligations.

____________________________ ______________________

BUYER'S SIGNATURE **DATE**

Thankfully, the offer was accepted, as written, without further negotiation, and I was on track to acquire **another great property, with tremendous cash flow, and significant upside, for $0 Money Down!**

So, I then began to farm the deal out to 2 of my banker friends, and I also contacted the current lender who had the deal. Surprisingly, the existing mortgage holder didn't want to pursue the deal, so I moved forward with the lender who offered me the best interest rate and most desirable terms: They agreed to fund the $20,000 in improvements, waive any prepayment penalties, forego the costly Phase I inspection, and delay my first payment for 45 days after closing. A copy of my investment summary that I submitted follows:

Breakdown of Total Loan Request

$1,800,000	Sale Price
$ 20,000	Property Improvements (Insomniac, Property Management Software, Security, Signage)
$1,820,000	**Total Cost**

Location Map

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Satellite/Aerial Photo

Brownsburg Yellow Pages

Tell the advertiser - "I found you in the AT&T Yellow Pages"

Storage 235

Storage
7 Days a Week

24 HOUR RENTAL STATION

Ask about our FREE TRUCK RENTAL

Available Sizes

5x10	10x10
10x15	10x18
10x20	10x25
10x30	10x40

Automated 24 Hour Rental Center

Avon Self Storage Locker
272-0160
71 Vista Parkway Avon
www.storenow.org

Kentucky Ave Self Storage
856-7500
4115 Heiney Rd
www.storenow2.com

Ownership

Storage-Household & Commercial -(Cont'd)

AVON SELF STORAGE ---------- 272-0160
★See Display Ad Page 234 & 235

AVON STORAGE KING
24 Hour / 7 Day Access
Free Truck Rental *
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See Display Ad This Heading
* Conditions Apply
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650 N Dale Schrier Dr Brownsburg

BROWNSBURG EAST SELF STORAGE LOCKER 1400 E Main St Brwnsbrg ---------- 852-0061

BROWNSBURG SELF STORAGE 1670 S Green St Brwnsbrg ---------- 852-6688
★See Display Ad Page 241

BROWNSBURG SELF STORAGE LOCKER INC 39 N Grant St Brwnsbrg ---------- 852-5050
★See Display Ad Page 241

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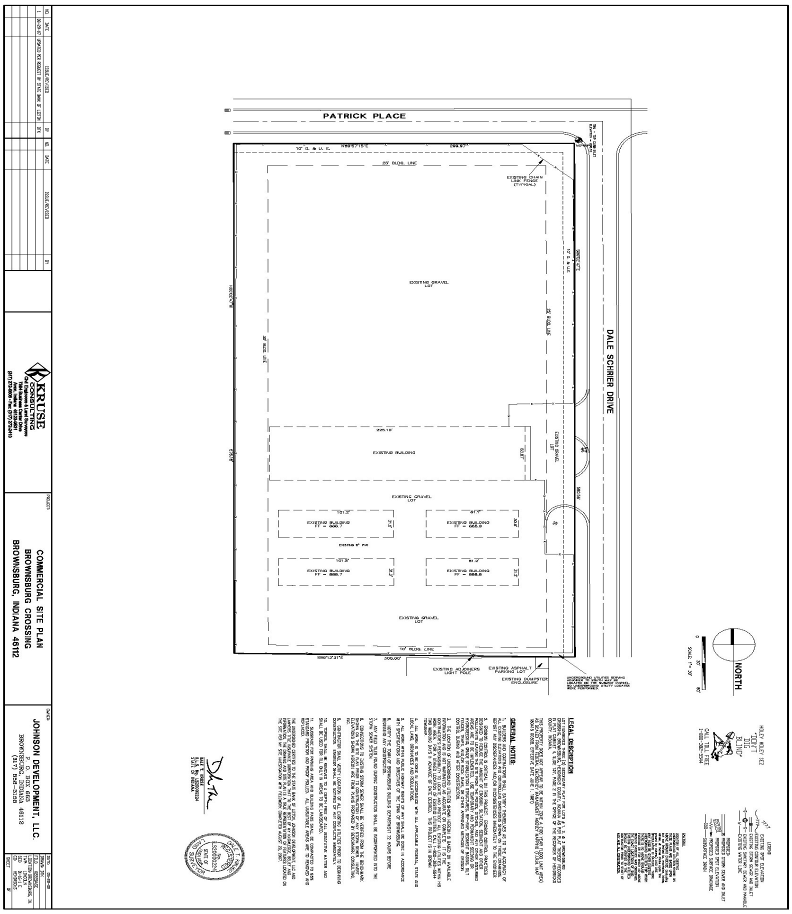
Site Plan



Market Profile and Competitive Landscape

- **See Appendix for Brownsburg ODESSA Report**

PROPERTY INFORMATION

History

The property was developed in 1994 from a vacant parcel of land by a local Brownsburg Developer. It was phased in beginning with 2 single story storage buildings and a small office on the end of the 2nd building. 3 more buildings were added, the last of which included a 2-story office building, and a number of climate-controlled units, and several large units for small businesses or Indoor RV parking. There is roughly 2.5 acres devoted to RV/Boat parking or for further development.

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Access to the site is controlled via a computer integrated gate system. When customers fail to pay their rent, access is denied.

Location

Strategically located in Brownsburg, Indiana adjacent to I-74 and the Reagan bypass, the property has easy, convenient access to I-74, and the Bypass, and the city of Brownsburg. The location's ease of access makes it very desirable for commercial customers living and working in the immediate area, or when using the site as a staging area for Metro Indianapolis.

Along with the site's existing strong commercial tenancy, the location enjoys a certain exclusivity of use within the property's area of influence. As evidenced elsewhere in this report, there is no competitive product within five miles to the site's immediate east and few competitors to the property's northeast. This lack of direct competition coupled with strong self-storage demographics and the property's existing commercial client base all substantiate the validity of the site's present use as a self storage facility.

Image and Name Recognition

The property enjoys good name recognition within its area of influence, and is recognized as a quality self-storage provider. It is located directly across from the Brownsburg Crossing Apartment Complex, a 560-unit property to which the facility receives a fair amount of customers. Alcatraz Storage™ plans to rebrand the facility under the Alcatraz name in an effort to combine marketing efforts, and to maximize placement in the yellow page ads.

Existing Staffing

The property is currently staffed by 1 full time employee and labor is subcontracted to complete tasks that are beyond the scope of the on-site manager.

Operating Performance

As of June 30, 2007, the property is operating at the following levels of performance:

Unit Occupancy	78.2 %
Square Footage Occupancy	82.4%
Economic Occupancy	80.1%

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From an operating perspective, the ratios of these key result areas indicate a well administered rent roll. When rates are static, Economic Occupancy should routinely fall between the Unit and Square Footage Occupancies. Additionally, these ratios indicate an adjustment in unit type and mix should be investigated. The relatively large spread between the square footage occupancy and the percentage of units occupied indicate a relative weakness in smaller unit types.

Operating Ratio	36.2%

(**January-June 2007 Annualized Operating Expense/Gross Income)**

One of the key operating ratios regarding expenses is derived by dividing the total operating expense by the recognized income. This site's annualized ratio is higher than normal as a result of several inefficiencies. Primarily, the site manager does not handle the budgets, nor calculate usage or abnormalities in costs and there is no effective energy conservation plan.

While this property has enjoyed a good reputation within the local marketplace, it is beginning to suffer the effects of minor corrective deferred maintenance. Painting, parking lot maintenance, camera and video surveillance and operating software are approaching the end of their useful lives.

During the interview of the existing on-site manager we confirmed that no site-specific marketing or merchandising campaigns have been utilized to increase the site's occupancy or rate structure since the facility opened. Since the store is surrounded by a strong renter-based housing market, the potential demand for small unit types is enormous. This lack of aggressive merchandising, when coupled with the property's already strong commercial customer base provides real opportunity for general occupancy growth.

Competitive Area of Influence

The subject property's area of probable influence is outlined on the map above. Bounded on the North by I-74, the South by the new Reagan Bypass, The West by 56th St., and the East by the Brownsburg Crossing Apartments, the property benefits from the two critical locations attributes necessary for self storage success, exclusivity and accessibility. With little competition the North and East, proximity to a major intersection and I-74 access, access to the site is among the best located in the Metro area.

Competition

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Competition within a three-mile radius is largely scattered along S.R. 267 and U.S. 136. The sites are typically first-generation product, in average condition, and most do not offer climate-controlled storage or other more modern amenities.

Typical Competitors and Rates

Competitive Supply within 5 Mile Radius

Facility	Square Feet	# of Units	$Rent/Square Ft.
Access Self Storage	56,000	445	$1.58
Best Self Storage	34,000	298	$1.41
AAA Self Storage	28,000	159	$1.78
U-Save Self Storage	19,000	141	$1.39

Financial Overview

Operating reports for the facility show a fairly stable and growing economic occupancy. Column 3 shows pro forma NOI for fiscal year 2008.

	2006	2007	
INCOME	Amount	Amount	Amount
Gross Rents :	$198,078	$201,768	$218,484
Parking :	$0	$0	$0
Truck Rental	$345	$437	$452
Revenues :	$198,423	$202,205	$218,936
Vacancy :	$0	$0	
Lease Variance :	$0	$0	$0
Concessions :	$0	$0	$0
Effective Gross:	$198,423	$202,205	$218,936
EXPENSES			
Real Estate Tax :	$15,600	$15,600	$15,600
Insurance :	$4,800	$4,899	$4,800
Management :	$14,536	$13,890	$10,400
Utilities :	$10,897	$9,267	$9,360

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Payroll & Benefits :	$0	$0	$0
Contract Services :	$398	$412	$512
General & Admin :	$983	$467	$785
Repair & Maintnce:	$3,456	$3,789	$2,400
Advertising :	$974	$956	$1,008
Trash:	$412	$412	$399
Other :	$0	$0	$0
TOTAL EXPENSES:	**$52,056**	**$49,692**	**$45,264**
NOI	**$146,367**	**$152,513**	$173,672
Replacement Reserve:	$0	$0	$0
	-		
Cash Flow	**$146,367**	**$152,513**	**$173,672**

Proposed Operating Improvements

After careful consideration of this property's past performance and a thorough review of the Brownsburg, Indiana sub-market, we propose the following changes to operations and management at Alcatraz Storage at Brownsburg Crossing:

- Implement an immediate merchandising campaign to all local apartment communities. This marketing effort will redefine our presence, convenience, and location to the area multi-family managers. Coupled and integral to this direct marketing campaign, will be a cash referral bonus paid to the referring manager for each new customer.
- Implement an immediate increase in the property's "Street Rates". As is evidenced elsewhere in this report, and accompanying addenda, the property's existing rate structure is well below that of the competition. By first increasing rents to new customers only, we allow a "safe haven" test approach to strategically setting rates.
- Once the validity of our projections and adjusted rates are confirmed, via testing to new customers, a general rate increase will be assessed bringing all existing customers to the new market rates. This increase is projected to take place in Month 5 of the accompanying pro-forma income and expenses and increases the Gross Possible Rental Income stream by approximately 10%.

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- Eliminate unnecessary line item expenses. This procedure will begin upon acquisition with a reduction of telephone lines, duplicate services and a more structured buying procedure for property services and supplies. Additionally, an energy audit of the climate-controlled space will be conducted and immediate implementation of those findings is anticipated.
- Remove the excess undergrowth and volunteer vegetation from along I-74. Over the past several years, an excessive amount of brush and undergrowth has filled an unused area between the property's North side and the Highway Department Right of Way obscuring the site's primary locator sign. Communications with the City of Brownsburg have confirmed that it was acceptable to remove volunteer brush and undergrowth so long as it is on the developed parcel and not on the highway's right of way.
- Correction of deferred maintenance items. While the site is in good general condition, there are several items that if given immediate attention will have a direct and positive impact on the property's economic performance. The major components of this corrective action are:
- Removal of undergrowth
- Pressure washing of the North side of Main building and signage.
- Installation of new signage, and implementation of Alcatraz™ Storage Branding.
- Installation of Open Tech Alliance Insomniac Kiosk for 24-hour leasing and payments, in conjunction with the new Marketing campaign and Yellow page ads.
- Conversion of the 2nd story vacant office into a full functioning business center with conference table, pc with internet access, printer, and fax.
- Addition of Awnings at the front of the property.
- Complete an Energy Consumption audit and implement conclusions.
- Add Alcatraz Storage™ Signage, entry mat, window sticker, and posters to the rental office and install a Flat panel Monitor on back wall for the video surveillance system.
- Replace current Property management software with an online Property Management software in April of 2008 from our preferred software vendor.

Resume of Principal

Scott Meyers has been the president of Alcatraz Storage™ and its affiliated companies since 1993. His current full-time responsibilities for all companies include the supervision of all aspects of acquisitions, management & operations, construction, financial oversight, and daily strategy meetings with staffers.

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Scott began his real estate career by purchasing, rehabbing, and selling a single-family house with no money out of his own pocket. He took that knowledge and built on it to eventually buy, rehab, and sell over 75 single family homes in the Indianapolis area valued at over $6,000,000.

He quickly graduated into the into the commercial real estate arena by purchasing, rehabbing, and selling over 400 Apartment units in 4 separate developments valued at over $7,000,000.

In addition, Scott was previously the Owner and Executive Director of Indiana's largest Private, Small Business Incubator; a 200,000 s.f. facility with 80 tenant-clients, designed to assist small companies in the start-up phase.

Scott currently owns and manages several thousand self storage units in multiple facilities throughout the Midwest and plans to continue to grow his current portfolio.

Scott is the Founder and current President of the Self Storage Association of Indiana, the statewide chapter of the National Self Storage Association (SSA) and received his Certified Self Storage Manager Designation (CSSM) through the National Self Storage Association in September of 2007. He has also taken several executive level courses and attends numerous seminars and tradeshows sponsored by the Self Storage Association on an annual basis.

Scott was also selected by The Indianapolis Business Journal for its annual 40 under 40 list of up and coming Indiana business owners in 2007 for his accomplishments in mentoring small businesses through his small business incubator, and the many successes he has enjoyed in his own business, Alcatraz Storage™

Scott was the past President of the Central Indiana Real Estate Investors Association (CIREIA) from 2003-2004 in which he doubled the group's membership over 2 years from roughly 300 members to approximately 600. In addition, CIREIA won 2 awards of excellence in successive years from The National Real Estate Investors Association as being the best run group in the country under Scott's direction. Scott was also the cofounder of the Indiana Real Estate Investors Association (IREIA) in 2005 and served as the annual conference chairperson for 2005 and 2006.

In April of 2006, Scott was invited to serve on the Indianapolis Economic Development Advisory board which acts as an advocate for economic development programs and projects in Indianapolis and the surrounding communities.

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Scott also spent several years as an instructor of the Landlord 101 course through the University of Indianapolis in partnership with The Central Indiana Real Estate Investors Association.

Scott received his Certified Apartment Manager (CAM) through the National Apartment Association in 2004 and was a member from 2001-2006.

He has also been a member of the Indiana Chapter of the Young Entrepreneur's organization (YEO) since 2000.

Scott has held an Indiana real estate license since 1998 and has brokered hundreds of deals worth over $12 million dollars.

Scott is also a Crown Financial Ministries instructor and Budget Counselor, and directs the financial ministries at the church he and his family attend.

Scott attended the University of Michigan and worked 8 years in the telecommunications and software industries before starting he founded his own real estate companies.

Summary

Our loan proposal was approved, and we began to move forward with the due diligence. Nothing really stood out until we received the property tax rate card. The taxes were understated in the offering summary, which is what we based our offer on. I brought this to the attention of the broker, and asked for a $25,000 deduction in the purchase price to offset the $2,500 annual difference between his listing and the actual amount ($2,500 ÷ .10=$25,000) since we had negotiated to a 10% cap rate. He brought this to the sellers, and they agreed, reluctantly, but they agreed to the price reduction. We then moved forward and had a pretty smooth closing, in which I walked out with $14,000 in cash after rent and tax pro-rations! Since that time, we have begun plans to change the signage and brand name of the facility to Alcatraz Storage™, add a business center, begin the construction of an additional building, install the Insomniac Kiosk, add a retail center, and upgrade the property management software to a web-based system. Occupancy is up, and we have been extremely pleased with this new acquisition. Plans are to hold for at least 3 years which will give us time to erect and lease up 3 more buildings to maximize the parcel, pave the entire lot, and then either refinance or sell, roughly doubling our money!

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This was a fairly typical deal for us, but represents a fantastic opportunity that isn't normally found in the market. The lesson learned here is that you must be prepared to take advantage of opportunities such as these BEFORE they arise.

Having the confidence to move quickly on this opportunity is the single biggest reason I was able to acquire this property before someone else could. Having already established relationships with lenders, knowing how to work with brokers and sellers, coupled with our superior due diligence knowledge, gave us an edge that many of my competitors don't possess.

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