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 Enterprise Risk Management Solutions for the Storage Community
 Summer 2008

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Buyer Beware: The Potential Risks of Buying Someone Else's Facility

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Developing and operating a self-storage property has inherent risks that must be considered by each of us if we expect our store to be successful. Buying someone else's facility mandates that we not only consider the risks we know, but that we consider risks with which we may not be as familiar.



The standard criteria considered when building a self-storage facility is still relevant when considering the purchase of one built by someone else. This thought process typically is focused upon the trade area in which the store will operate and the location in that trade area. Failing to consider the following could potentially position an acquired store for failure.

- ❖ **Population** – The density of the population within a three-mile radius of the store must be sufficient to supply an adequate demand for the store's product both now and in the future. This factor has significant impact on whether occupancy and rates can meet growth projections.
- ❖ **Median Income** – Median household income within the trade area must be such that a potential customer can afford the store's product at a price the store must command.
- ❖ **Location & Presence** – The store's visibility to potential customers and its proximity to these customers as they conduct their daily business is paramount to its success. A store that is difficult to access or distinguish as storage or one that is on the periphery of where customers congregate operates at a significant disadvantage.
- ❖ **Competition** – The importance of understanding the quality, the product offered, the rates, and the occupancies of competitors within the trade area cannot be underestimated. A store positioned within a trade area where there are high levels of vacancy, low competition rates, or competition with product quality superior to that offered by the store itself is handicapping its ability to perform.
- ❖ **Barriers to Entry** – The ability for new competition to enter into the trade

area should also be considered, for what looks like a good property today maybe out-positioned by a competitor in the future. Acquirers of storage properties need to understand zoning required for self-storage, where those properties are located in the trade areas, and if there are any properties being entitled for self-storage in the trade area.



These criteria are relevant when evaluating the prospect of building a new facility or acquiring one that has been built by someone else. Failure to consider and evaluate risks more specific to acquisitions can also compromise success. Generally, these risks can be mitigated when the buyer commits to a sound "due diligence" process.

As with developing, an acquired self-storage facility must also have a solid purchase and sale agreement. It is highly recommended that this agreement be reviewed by a real estate attorney on the buyer's behalf in order to minimize risk prior to and after closing. After the buyer and seller have executed the purchase and sale agreement, the buyer should also consider the items below as part of the due diligence process.

- ❑ **Phase 1 Environmental Report** – This review, conducted by an environmental consulting firm, evaluates the subject property for any environmental issues as well as surrounding properties that may have affected the subject property. Buying a property that has environmental issues may make the property unsalable or cost a significant amount of money to remediate in the future.

- ❑ **Survey** – This depicts the storage property's property lines, what is on the property, as well as critical items like easements, encroachments, and utilities. Not knowing items such as where easements are located or that you and an adjacent property have an encroachment issue may be costly in the future.

These items are a foundation to minimizing a buyer's risk although understanding the store's financial and operating results are a vital part of minimizing risk associated with an existing facility acquisition. The seller and/or the broker representing the seller should provide information depicting store performance over previous time periods to the buyer. With that in mind, it is of paramount importance to understand this information in detail. Areas requiring particular attention include:



- ❑ **Rental Income** – Reported revenues at the store must be validated. It is especially important to understand fully how rates on occupied units (less any store credits) are totaled to reach the reported income number. It is also sound business practice to reconcile "spikes" in monthly income. Revenue items (cell tower deposits and/or forfeited earnest monies, etc.) that cannot be generated through the general course of business in subsequent years should not be utilized in any revenue calculation. An error here affects the value of the property (purchase price) and ultimately the expected return.

- ❑ **Cell Tower/Billboard Income** – Revenues derived from these sources are typically contractual in nature. If these revenues are used in the purchase price calculation, it will be prudent as a buyer to understand the contract length as well as rate changes afforded within the contract that affect future store performance.

- ❑ **Accounts Receivable** – Revenue not collected is a potential write-off. Gaining a thorough understanding of what actually is collectable and making appropriate agreements on the course of action within the purchase contract are sound decisions.

- ❑ **Marketing** – If store revenue growth has been slower than expected, then a marketing initiative of some nature could be considered. Failing to build this cost into the purchase analysis may inaccurately reflect the amounts borrowed and ultimately future cash flows.

❑ **Real Estate Taxes** – A review of financial statements provided by the seller will clearly identify real estate taxes paid over time. A sale or purchase of the property may dramatically influence that tax basis and therefore future real estate taxes owed. A review of the tax assessment and future liability by a tax professional is a safeguard against unwelcome surprises in the future.

❑ **Repairs & Maintenance** – Understanding the costs of making the acquired store operational can be challenging. Re-branding, adjusting unit sizes and/or mixes, remodeling the retail office, and/or making repairs that have been deferred by the seller can be sizable expenses, yet, if not completed, they may negatively affect store performance. Planning for these issues in detail and in advance provides for a platform from which the store can prosper.

❑ **Operating Expenses** – As with rental income, it is important to understand the trailing expense structure provided by the seller as it relates to operating the store. Adjusting these costs to one's experience adds validity to these projections.



At the end of the day, the purpose of all due diligence is to assist the buyer in establishing an appropriate purchase price and to project an acceptable future rate of return. Risks in a purchase of this magnitude can never be eliminated, though they can certainly be mitigated. The best safeguard against risk is an educated buyer executing a well thought out business plan after purchase.

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