

Self Storage Purchase/Sale Best Practices:

Preventing Issues with a Sound Purchase and Sale Agreement

Missouri Self Storage Owners Association – Spring Conference

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Introduction: Precursors to Purchase/Sale Agreement

Build a Team

- Qualified Commercial Real Estate Broker with Self Storage Expertise
- Bankers/ Loan Brokers
- Conduct a feasibility/market study of geographic area
- CPA and Attorney to discuss formation of Purchaser Entity and taxation structure
- engaging IP attorney to assist discuss trademark protection and filing trademark applications

Letter of Intent: Key Terms

- Parties
- Property Description
- Purchase Price
- Earnest Money
- Contingencies
- Due Diligence (Inspection) Period
- Closing Date
- Representations/Warranties of Seller
- Termination Rights of Buyer
- Confidentiality
- Non-Binding Nature

Letter of Intent: Non-Binding Language

- All LOIs should include non-binding language, such as:

This letter of intent should not be considered as a commitment to sell or purchase by either party, as the purchase and sale is expressly conditioned upon the execution and delivery of a mutually satisfactory Purchase and Sale Agreement. Nothing contained in this letter of intent shall be deemed or construed to constitute a binding agreement between the parties.

A. Key Provisions in Real Estate Purchase and Sale Contracts

- Parties
- Property Description
- Purchase Price
- Earnest Money
- Allocation of Purchase Price
- Prorations
- Contingencies
- Due Diligence Period
- Title and Survey Matters
- Closing Date
- Representations/Warranties
- Seller Deliverables
- Self Storage Leases
- Non Storage Leases
- Environmental Provisions
- Closing Conditions
- Risk of Loss
- Default; Remedies; Termination

Key Provisions

- Parties
 - Confirm exact legal names of entities/persons entering into the transaction.
- Property Description
 - all real property, personal property and fixtures, contracts, and intangible property
 - Any and all leases, occupancy agreements, rents security deposits
 - licenses, warranties, guarantees, permits, trade names, domain names, phone numbers and other intellectual property relating to or used in connection with the Self Storage Facility; and
 - all personal property, furniture, fixtures and equipment used for the daily operation of the Self Storage Facility

Key Provisions

- Purchase Price and Earnest Money Deposit
- Prorations and Apportionments
 - Costs and expenses should be prorated and apportioned between the seller and the buyer: *Title Insurance, Escrow Fees, Real Estate Taxes and Assessments, Insurance, Transfer Taxes, Recording Fees, Utility Charges, Rental Income, Commissions, and Other Costs.*
 - Rent Prorations
 - Credit Seller for 0-30 past due Tenants, <30 days past due is a receivable being purchased as part of sale transaction
 - OR set a period post-closing for incoming rent payments to allocate to amounts prior to closing to Seller
 - Check local custom

Key Provisions

Allocation of Purchase Price

- important negotiating point in the purchase a self-storage facility will provide the new owner with the maximum tax benefit and cash flow.
- The structure needs to be outlined in a closing document and must include a value for each of the following categories:
 - **Land**
 - **Building/improvement**
 - **Furniture/fixtures/equipment (FFE)**
 - **Goodwill/Intangibles**

Key Provisions

Allocation of Purchase Price

*****Involve your CPA in the process*****

Impact on Seller

- the higher the allocation of the Purchase Price to items generating capital gains (land and goodwill), as opposed to assets involving depreciation recapture, the better. Capital gains taxation generally lower rate than ordinary income rate

Impact on Buyer

- For a self storage buyer, the goal of the price allocation is income tax deductions of the acquisition of the property or business:

Land:

- This is not a depreciable asset for buyers; therefore, any allocation to land is non-deductible for the buyer in future years. Instead, the amount allocated to land would reduce future capital gains when the buyer looks to sell the property.

Land Improvements, Buildings and Equipment:

- This is 39-year depreciable. To determine value, look for guidance from the tax assessment or appraisal. The language to be included in the closing document should be that the new owner may do a cost-segregation study. This will break down the building/improvement into 5, 15, 15 and 39-year components to accelerate the depreciation and provide an immediate tax benefit.

Goodwill/Intangible:

- Intangible asset arising as a result of name of the Self Storage Facility, reputation, customer loyalty, location, products, and similar factors not separately identified
- Section 197 Tax Code - For tax purposes, goodwill is able to be deducted, via amortization of the adjusted basis over 15 years beginning in the month the Self Storage Facility was acquired.
- While amortization cannot be accelerated like depreciation, it tends to be a good middle ground for negotiating sales price allocations as there is a benefit for both sides.

Key Provisions

• **Contingencies to Closing**

- Consider “Free Look” concept for Due Diligence Period
- financing approval
- appraised value
- Occupancy rate threshold % at Closing
- representations and warranties of Seller being true and correct on closing date
- all taxes and assessments being paid
- certain permits/licenses being obtained
- no change in the condition of the property (other than ordinary wear and tear)
- all monetary liens released

Key Provisions

- Due Diligence/Inspection Period
 - Buyer's right to investigate the property
 - Duration [e.g., *90 days after execution of the Purchase and Sale Agreement or 90 days after buyer's receipt of the title commitment*]
 - Consider Lender's needs regarding timing
 - SBA 504 Underwriting process
 - Earnest money typically becomes nonrefundable (except in the event of a Seller default) at the end of the due diligence period

Key Provisions

• Title and Survey Matters

- Review the title commitment, all underlying exception documents, and the ALTA survey
 - Location of easements
 - Setback lines
 - Restrictive covenants
 - Encroachments from adjacent parcel or onto adjacent parcel
 - Flood plain??
 - Public road access
- Timing of Buyer's right to object, Seller's cure period, and, if not so cured, Buyer's right to terminate

Key Provisions

• Zoning Verification

- Written Request from prospective buyers to applicable Government Authority of zoning laws related to the particular property based on the current zoning code.
- Zoning verification letter
 - provides a description of the zoning district, references to any applicable zoning and development standards
 - provides information on legal land uses, zoning, zoning district performance standards, development history, and compliance.
 - In most cases does not verify compliance with development regulations, parking, or certify legal non-conforming status.
- Verify whether permitted use as self storage facility
- Verify no requirements post closing (i.e. conditional use permit, pave parking areas, fencing, etc.)

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Key Provisions

- Closing Date
 - Tied to a specific date [e.g., *on or before July 1, 2021*] or a specific event [e.g., *15 days after expiration of the due diligence period*]
- Representations and Warranties
 - Provided by the seller to the buyer
 - Induce the Buyer to enter into the transaction
 - Heavily negotiated in a self storage transaction
- Leases
 - Buyer's right to review
 - Tenant estoppel certificates

Key Provisions

Reps and Warranties of Seller:

- True, correct and complete copies of all leases have been furnished to by Seller to Buyer and a true, correct and complete copy of the Rent Roll as of the execution of this Agreement has been delivered to Buyer (which Seller shall update and deliver to Buyer prior to the Closing Date).
- Other than as specified on the Rent Roll, there is no security deposit under any of the Leases, none of the Tenants is entitled to any concession, rebate, allowance or free rent for any period on or after the Closing, and all of the Leases are to third parties unrelated to the Seller.

Key Provisions

Reps and Warranties of Seller (Continued):

- Each of the Leases represent the entire agreement between Seller and the applicable tenant in connection with each tenant's leasing and use of the Property.
- No work is required to be performed by Seller under the Leases.
- Seller and the Property are and have been at all times during Seller's ownership of the Property in compliance with all federal, state, county, or city statute, ordinances, laws, codes, rules, and regulations. Seller has received no notice concerning the Property from any governmental authority about a violation of any federal, state, county, or city statute, ordinance, law, code, rule, or regulation or stating that any investigation has commenced or is contemplated regarding any violation.

Key Provisions

Reps and Warranties of Seller (Continued):

- Seller is not party to any service contracts, management contracts or other comparable agreements that are binding upon the Land and the Improvements.
- Seller has operated the Property in compliance with all environmental laws and not caused nor, to Seller's knowledge, has any third party caused any contamination.....Seller has received no notice that the Property or any portion thereof contains any hazardous substances
- (to the knowledge of Seller) The improvements on the Property are in good order and operating condition with no material defects.

Key Provisions

Reps and Warranties & Covenants of Seller (Continued):

- Any and all information, including the financial statements, occupancy reports, vacancy and abandonment rates, and lien sales, that Seller has provided to Buyer pursuant to the terms of this Agreement was true, correct and complete at the time provided and there have occurred no events that would cause a material adverse change to such information.
- Prior to the Closing Date, Seller shall remove all equipment that Buyer requests to be removed from the Property. Any such items of equipment not removed from the Property by the Closing Date may, at Buyer's option, be deemed abandoned by Seller and Buyer may, in its discretion, remove and dispose of such items at Seller's cost and expense.
- As of the Closing Date, all of the employees of Seller shall be terminated as employees of the Seller (at Seller's cost) and Seller as of the Closing Date will have discharged all of its financial obligations with regard to vacation pay or plans, health and welfare plans, retirement plans, 401 (k) plans, severance or termination plan....in no event shall Buyer be required to hire any employee of Seller.
- True and correct on PSA execution date and certified again correct on the Closing Date
- Survival of Reps and Warranties (6 months – 2 Years or indefinite)

Key Provisions

- **Environmental**
 - Buyer's right to review environmental issues
 - Phase 1 Environmental Assessment
 - Liability shifting

Seller Deliverables

- 1. Monthly Income statements for 2019, 2020, and 2021 YTD**
- 2. Bank statements (last 24 months) specifically itemized**
- 3. Federal Tax returns for past 3 years**
- 3. Detailed capital expenditure summary for 2019-YTD**
- 4. Monthly occupancy and management reports for 2018, 2019, and 2020 YTD**
- 5. Current rent roll with Tenant/Unit details including**
 - a. Current rent and historical rate increases**
 - b. Rent concessions/discounts and duration**
 - c. Balance of outstanding collections**
 - d. Security deposit**
- 7. Standard tenant self-storage lease agreement**
- 8. Summary of any tenant lease agreements that do not conform to standard agreement**
- 9. All leases associated with the leasing of non-storage facilities (commercial space, billboards, cell towers, etc.)**
- 10. Historic lien sales**

Seller Deliverables (continued)

1. Personnel summary including names, titles, status (FT/PT), pay rates
2. Any employment agreements for current employees
3. Utility and tax (Real and Personal property) bills relating to the Property for prior 24 months
4. Copies of all service contracts and license agreements
5. Contact information for all utilities
6. Maintenance records for maintenance of the Property for the prior 24 months
7. List of all personal property and inventory included in transaction
8. List of all intangibles including trademarks, domain names, websites, and phone numbers Roof warranty and any other equipment warranties still in effect
9. Insurance policy and/or certificate
10. Insurance Loss Run for prior 3 years (Claim activity)
11. Building Plan, architectural drawings, and specifications relating to the Property
12. Engineering/construction reports and any associated warranties/guarantees
13. Any government inspection reports
14. Existing Surveys and site plans of Property
15. Lot size and Zoning information of Property
16. Environmental reports, studies or documentation
17. Permits, Licenses, and Certificate of Occupancy related to Property
18. List of outstanding litigation
19. Flood certificate (if applicable)

Key Provisions

- **Closing Conditions/Deliveries**

- Items needed to consummate the sale
- Buyer's last opportunity to retain the earnest money

- **Risk of Loss**

- What happens in the event of condemnation, destruction or damage to the Self Storage Facility prior to closing?

Closing Requirements

- Special Warranty Deed
- Assignment of Leases;
- Title Company Affidavits as reasonably requested to remove the so-called “standard” exceptions to a title policy on the Property
- Mortgage payoff letters and lien releases related to the Seller Cure Items;
- Closing statement conforming to the proration and other relevant provisions of this Agreement,
- Assignment and Assumption of Contracts and Intangibles in the form attached hereto as EXHIBIT K;
- Quit Claim Bill of Sale
- Authority of Seller;
- all keys, electronic codes, electronic key cards, passwords and any and all other such security devices in Seller’s possession relating to the Property;
- Letter notifying the Tenants of the sale of the Property and the assignment of the Leases and directing the Tenants to make future payments of rent under their Leases to Purchaser;
- true, correct and complete copies of the Rent Roll, Leases and Contracts;
- true, correct and complete copies of the books and records of the Seller relating to the Property, including any permits with respect to the Property;
- an estoppel certificate from each commercial tenant occupying any non-storage portion of the Property;
- true, correct and complete copies of any and all occupancy reports, vacancy and abandonment rates, and lien sale information pertaining to the Property;
- a Certificate certifying that all of the Seller’s representations and warranties contained herein are true and correct as of the Closing Date and that Seller has complied with all covenants contained herein

Key Provisions

- **Default; Remedies; Termination**
 - Rights and remedies in the event of a default
- **Other deal specific provisions**
 - Non-Compete and Non-Solicitation of current owner ?
 - Can current owner own and operate another facility down the street?
 - Post-Closing assistance from Seller for turnover of electronic data and software conversion
 - Communications to Tenants regarding transfer of ownership

B. Common Shortfalls/Traps in Boilerplate Contract Forms

- Fail to convey all property
- Mistakes regarding earnest money
- Rigid dates (knowing loan underwriting timeline)
- Incorrect prorations and apportionments
- Lacking Seller representations and warranties
- No survival period for reps/warranties
- Failure to require certain closing documents

C. Proper Identification of Property Included – Real, Personal and Other

- Necessary to prevent confusion, ambiguities and litigation
- Exact scope of property should be determined and listed in the Purchase and Sale Agreement
- Purchase and Sale Agreement should specify any property that is excluded from the sale

D. Earnest Money Liquidated Damages & Right to Refund for Non-Defaulting Buyer

- Seller sole remedy = retaining the earnest money
- Buyer = right to terminate and a return of the earnest money, sue for damages, or specific performance.

E. Representations & Warranties

- Heavily negotiated
- Provide an additional investigative tool to help speed up Buyer's due diligence to get to closing earlier
- Recourse in the event of a misrepresentation (Indemnity)

Representations & Warranties

- Status of the Property
 - Good Title
 - No Condemnation
 - Compliance with Laws
 - No Unrecorded Liens
 - Physical Condition of Buildings
 - Environmental Compliance
- Operation of the Property
 - Leases
 - Accuracy of Books and Records/Rent Roll
 - Tenant Rights
 - Other Agreements Affecting the Property

F. Due Diligence Deadlines

- Add table of relevant dates as contract exhibit
- Avoids potential conflict
- Internal tracking

Tips for Self Storage Sellers

Selling commercial real estate takes patience and requires planning and attention to detail. Self storage operators have many factors to consider when preparing to sell self storage property.

- 1. Complete Repairs and Improve Property Appearance** Before placing your self storage property for sale, evaluate the facility from top to bottom. Repair anything that's damaged, outdated or broken. Remove waste and clean the floors, sidewalks and customer service areas.
- 2. Remove Municipal Violations and Resolve Zoning Issues.** It is extremely important to a purchaser that governmental approvals, licenses and certificates are organized and up-to-date. Buyers in today's economy require financing, which often involves checking all applicable permits and approvals for banks and lenders.
- 3. Produce Complete and Accurate Financial Statements.** A self storage buyer may rely solely on the operational costs and expenses from the trailing 3 years months.
- 4. Review and Organize the Rent Roll.** Analyze your self storage rent roll and categorize each storage unit's attributes, including interior, ground floor, climate-controlled, etc.
- 5. Compile and Organize Other Relevant Documentation.** Lien history, insurance claims, occupancy reports, etc.
- 6. Meet with Professionals.** Engage a Qualified Self Storage Broker, CPA, & Attorney.

Thank you!

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