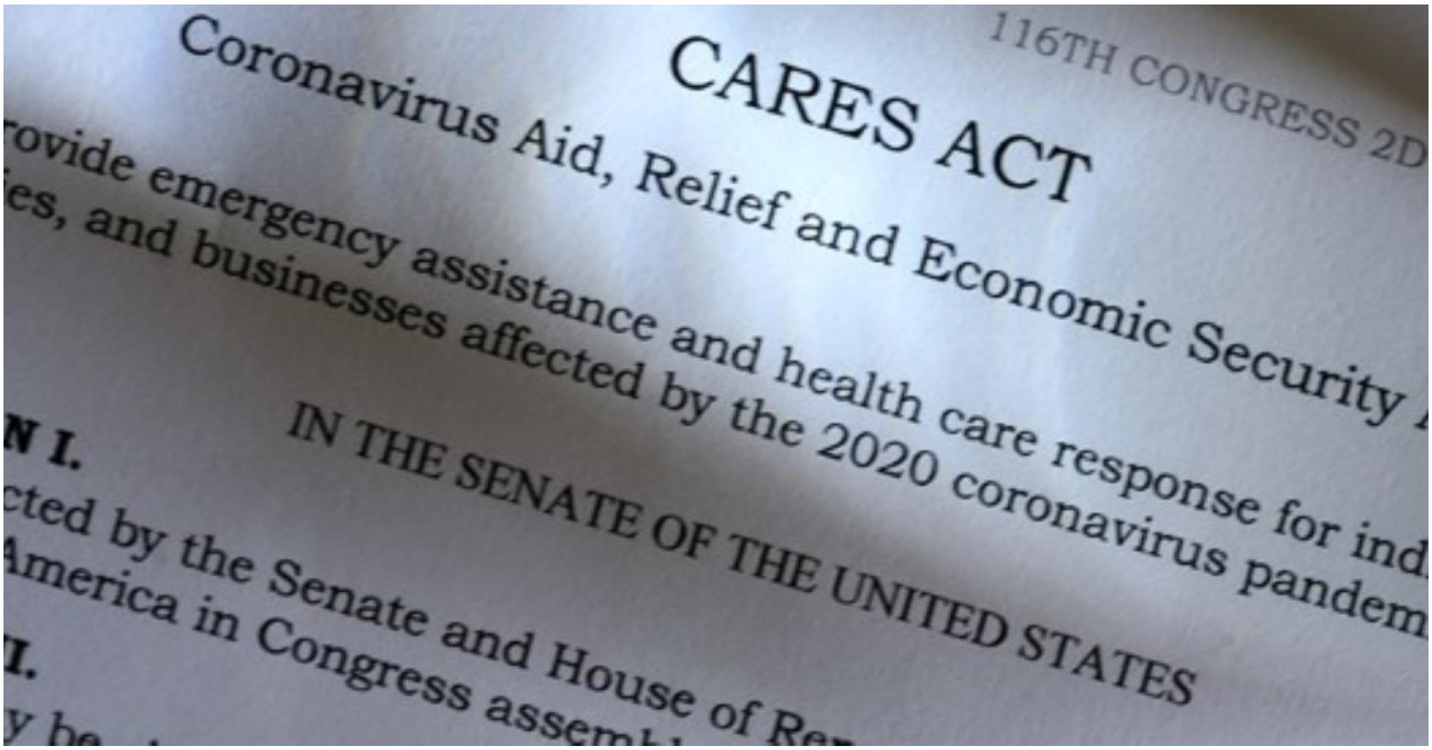
ISS INSIDE SELF-STORAGE



How the Self Storage Industry Can Benefit from the 2020 CARES Act

The federal government passed the $2.2 trillion CARES (Coronavirus Aid, Relief, and Economic Security) Act last month to help individuals and businesses cope with the financial impact of the COVID-19 pandemic. Read how self-storage operations may benefit.

Laura Williams-Tracy | Apr 20, 2020

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SELF STORAGE ASSOCIATION

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Amid a global pandemic that's rapidly halting economic growth and threatening a double-digit unemployment rate, President Donald Trump signed the Coronavirus Aid, Relief, and Economic Security (CARES) Act in late March. The CARES Act will provide approximately $2 trillion in emergency relief to blunt expected monumental losses to people and businesses in the wake of the pandemic.

It's unknown what impact the sharp economic downturn will have on the self-storage industry, but concerned owners and operators can participate in provisions of the legislation to help them through this treacherous time. Here are the main benefits for facility operators and investors:

- The potential to receive a forgivable loan through the Paycheck Protection Program (PPP) to keep staff paid through the duration of the pandemic
- Six months of loan payments for anyone holding a Small Business Administration (SBA) loan
- New provisions to tax law to accelerate depreciation and reduce 2019 tax obligations and potentially earn a refund from prior years

Paycheck Protection Program

SBA lenders are administering the PPP, which is funded with almost $350 billion from the CARES Act to help companies make payroll and avoid laying off workers. The expectation was the SBA would begin processing those requests beginning on April 3.

Under PPP, employers with fewer than 500 employees can apply to get a loan equivalent to two and a half times their average monthly payroll expenses, which includes healthcare and retirement costs for employees. The loans are made at a low fixed rate, according to details made available to lenders on April 1. Borrowers will make no payments for six months, and the total loan term is expected to be two years.

"The purpose is to keep employees being paid. Hopefully, two and a half months will cover expenses, so when we start coming out of this mess, this will tide you over for rent, utilities and salaries," says Terry Campbell, executive vice president of small business lending for Live Oak Bank, whose self-storage division specializes in financing for facility acquisitions, construction, expansion, refinancing or renovation, particularly through SBA loans.

What has piqued interest in PPP is a promise that if borrowers use the funds to keep people employed through June, keep paying bills and come out of the pandemic as a viable business, up to 100 percent of the loan can be forgiven—completely wiped clean—not as some sort of tax credit. The loans wouldn't be considered taxable income

"It's a heck of a program," Campbell says. "There are so many small businesses that, at any given time, are a month or less away from not being able to survive without their normal cash flow." Full guidance on how these loans are forgiven hasn't yet come from the SBA.

Good News for SBA Loan Holders

The CARES Act includes $17 billion to cover loan payments for businesses that already have SBA loans. That means self-storage owners in good standing won't have to make a payment on their SBA loan for six months. The payment, principal and interest will be made for them, with nothing added to the loan term. Owners don't need to apply—it'll happen automatically.

"It's a subsidy, a gift," Campbell notes. "If you got an SBA loan, the SBA is going to make that payment for six months. Borrowers don't believe it, and they want to see something in writing. I tell them, 'You are getting six months free.' They can't comprehend it."

The subsidy will likely be a boon to self-storage startups that received funding for their projects with an SBA loan and haven't refinanced to a conventional loan. Many of those projects are likely still in lease-up.

The SBA is also administering the Economic Injury Disaster Loan program. It's intended to cover certain expenses business owners can't cover during the crisis, with loans of up to $2 million, an interest rate of 3.75 percent and terms up to 30 years.

Tax Relief for Property Owners

The CARES Act also modifies the rules around net-operating losses, allowing real estate owners to reduce their current tax liabilities and potentially receive a tax refund, says Warren Dazzio, executive vice president of Cost Segregation Services Inc., an engineering-based consulting firm specializing in the U.S. tax code as well as cost-segregation and R&D studies.

Cost segregation (seg) is a process that defines assets within buildings that can be depreciated over a short period of time, thus accumulating large depreciation expenses for a year of operation. Cash-strapped self-storage owners can possibly create losses by participating in a cost-seg analysis and apply those losses to the 2019 tax year. Now that the deadline for paying 2019 taxes has been extended to July 15, owners can take the loss for 2019 and apply it to whatever they still owe, potentially allowing them to hold on to cash that would have otherwise gone to the government.

Under a process called a loss carry back—which was done away with by the 2017 Tax Cuts and Jobs Act and now reinvigorated under the CARES Act—a loss big enough to zero out any 2019 tax liability with more to spare can be applied to a year within the last five when a storage owner may have paid significant taxes, resulting in a refund check now.

For storage owners who've never done a cost-seg analysis, the potential tax savings are 20 percent to 40 percent of the value of the building asset, Dazzio says. Thus, on a $1 million dollar storage building, a $300,000 deduction multiplied by a 37 percent tax rate (for state and federal taxes combined) results in a tax savings of about $111,000. Here's how it works:

- Any commercial-building owner can use accelerated depreciation as long as the building is part of active income. A doctor, for example, who owns a self-storage business that generates passive income can zero out his tax liability for the current year with a cost-seg study but can't generate a loss through accelerated depreciation.
- A cost-seg study takes about six to eight weeks to complete. There's still time to complete a study ahead of the July 15 tax-filing deadline.
- Most firms will provide a pre-analysis to determine if the loss is likely to be large enough to warrant a full study. This will be an estimate of capital assets and how much depreciation can be accelerated. The pre-analysis takes about three business days.
- During a study, a team will analyze capital expenditures and break expenses into categories. The cost of interior doors and new partitions on an expansion can be depreciated over just five years, which is shorter than the overall building. Other capital expenses are depreciated over seven, 15 or 39 years. The more expenses that can be accelerated into shorter time periods, the greater the potential for losses.
- The results of the cost-seg study are given to the self-storage owner's accounting firm as part of tax-document preparation.
- If the loss is greater than the 2019 liability, property owners can take that loss backward to a prior "good year" when the owner may have paid a lot of taxes. An amended 2019 return would take you back to 2014, when you possibly had a gain. The losses are applied each year and carried forward until used up. The result

would be a tax refund from the prior years, resulting in a check from the government.

Cost-segregation studies are recommended for self-storage owners who've never done one or who've added buildings or made improvements to their property. "This is a way to hold on to your cash or possibly get cash back," Dazzio says.

Laura Williams-Tracy has been writing about the industry on behalf of the Self Storage Association (SSA) for more than a decade. Her articles focusing on business, finance and the economy run each month in "SSA Magazine," and her weekly online column, the "Self Storage Industry Report," can be viewed at https://www.ssamagazine.org . For more coverage of COVID-19 and how it's affecting the storage business, visit the SSA news page .