

# TAX

## Tax Advantages of Movable Units

By Von Whitby

Improving your return on investment in the self-storage business has traditionally been limited to controlling costs in the construction phase, securing customers that will pay fair price for the use of the facilities and services provided, and closely monitoring operating expenses.

Surprisingly enough, by focusing on the design and construction of a new storage facility to take advantage of the depreciation allowance offered to certain types of structures, a taxpayer can have more impact on the facility's cash flow than through almost any other single element of the business venture. By constructing your storage park to take full advantage of the current tax laws, you can greatly enhance your current cash return on investment with no adverse effect on the facility's functionality or customer appeal.

This opportunity has, until now, only been used by special operators who rent modular storage container units or recycled shipping containers that are portable. Unfortunately, these containers are very expensive (\$14 per square foot, or more) and they are limited in available unit sizes.

In what may look to some as modern day alchemy, there is now a new option available to mini-storage operators that offers complete size availability, attractive design, architectural aesthetics, portability, and building integrity that easily equals or exceeds frame or metal building construction, and it qualifies for seven year depreciation allowance instead of the usual thirty-nine years.

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*Constructing moveable units—such as the one in this picture—allows you to depreciate the cost of the facility in 7 years instead of 39*

### Tax Law that Enhances Your Investment

Simply stated, if you build and operate a self-storage park that is considered personal property, as defined in the Internal Revenue Code under Section 1245(a)(3), you can depreciate the cost of your facility over seven years instead of the traditional thirty-nine years allowed with Section 1250 real property.

To qualify as Section 1245(a)(3) property, tangible personal property, the units must be modular in nature and be moveable. Except for foundations, footings, and the floor, the buildings must be able to be moved or disassembled and moved without causing damage to the components of the building. If, however, the taxpayer does not intend to move or modify the structure, but instead intends to keep it as a permanent structure, the property should be considered real property under the Internal Revenue Code Section 1250. Traditional design, engineering, and construction with materials of steel, brick, wood, or cinder brick do not result in moveable and reusable buildings or storage units.

If it is clear the taxpayer intends to use the structure as a non-permanent facility, intending to change its present shape, size, or location, then the taxpayer should be able to consider the structure as Section 1245(a)(3), tangible personal property, depreciable over seven years.

### SPECIAL POINTS OF INTEREST:

- *You can greatly enhance cash flow by constructing your storage park to take advantage of current tax laws.*
- *By building a storage park that is considered tangible personal property, you can depreciate the cost of your facility over 7 years as oppose to 35 years with real property.*
- *Tangible personal property are units that are modular in nature and moveable.*

### The New Alternative

Up until now, the concept of building structures that have the stability and appearance of permanent structures, yet are completely demountable, has not been realized. There just wasn't anything in the marketplace that met the structural and aesthetic requirements needed for mini-storage that also has the construction and demountability characteristics required to qualify for tax purposes as tangible personal property.

That has now changed with the introduction of pre-engineered building systems that are completely demountable and designed for cost-effective construction, zero maintenance, and long-term service life. Visually, the structures appear to be standard frame and metal construction, so the zoning difficulties often faced when using modular container storage units are not an issue. The basic building block of one system is a 4' x 8' panel that is laminated with a urethane-based adhesive and encased in a tract type framework made of 50,000-pound yield strength 14-gauge galvanized steel. Various wood, stucco and galvanized steel finishes are available on the panels that are bolted together with galvanized steel connector columns for building assembly.

This alternative in mini-storage construction is cost competitive with steel buildings that hold the aesthetic appeal of frame or brick construction. After the concrete footings are completed, erection time for a typical mini-storage facility should be about 30 days, which is considerably shorter than traditional construction. The actual ability to unbolt and relocate the building is ideal for the operator who wants to construct a storage site on speculative property that increases in value over time. When a higher and better use for the property develops, the operator can simply move the building to a new location.

**Table 1**

Proforma for MD Modular Building Systems							
Year	1	2	3	4	5	6	7
Gross income at 90% occupancy	228,712	228,712	228,712	228,712	228,712	228,712	228,712
Annual operating expense	(109,000)	(109,000)	(109,000)	(109,000)	(109,000)	(109,000)	(109,000)
Depreciation	(108,417)	(186,269)	(133,910)	(96,425)	(69,654)	(69,230)	(69,139)
Taxable income	11,295	(66,557)	(14,198)	23,286	50,058	50,482	50,573
Income taxes (35%) or benefit	(3,953)	23,295	4,969	(8,150)	(17,520)	(17,669)	(17,701)
Income (loss) after taxes	7,342	(43,262)	(9,229)	15,136	32,538	32,813	32,872
Plus depreciation	108,417	186,269	133,910	96,425	69,654	69,230	69,139
Cash Flow	115,758	143,007	124,681	111,561	102,191	102,043	102,011

Proforma for Fixed Framed Structure							
Year	1	2	3	4	5	6	7
Gross income at 90% occupancy	228,712	228,712	228,712	228,712	228,712	228,712	228,712
Annual operating expense	(109,000)	(109,000)	(109,000)	(109,000)	(109,000)	(109,000)	(109,000)
Depreciation	(9,312)	(20,286)	(20,286)	(20,286)	(20,286)	(20,286)	(20,286)
Taxable income	110,399	99,425	99,425	99,425	99,425	99,425	99,425
Income taxes (35%) or benefit	(38,640)	(34,799)	(34,799)	(34,799)	(34,799)	(34,799)	(34,799)
Income (loss) after taxes	71,760	64,626	64,626	64,626	64,626	64,626	64,626
Plus depreciation	9,312	20,286	20,286	20,286	20,286	20,286	20,286
Cash Flow	81,072	84,913	84,913	84,913	84,913	84,913	84,913
Increased cash flow using MD building systems	34,687	58,094	39,768	26,649	17,279	17,130	17,098

**Table 2**

MD Modular Building Systems with Seven-Year Depreciation Allowance							
Year	1	2	3	4	5	6	7
Cash Flow	115,758	143,007	124,681	111,561	102,191	102,043	102,011
Cumulative Cash Flow	801,253						

Fixed Frame Structure with Thirty-Nine Year Depreciation Allowance							
Year	1	2	3	4	5	6	7
Cash Flow	81,072	84,913	84,913	84,913	84,913	84,913	84,913
Cumulative Cash Flow	590,548						
Increased cash flow using MD building systems	210,705						

### Understanding the Financial Incentives

**Table 1** illustrates the exceptional improvements to cash flow in the first seven years of operation of a facility if it is designed and built to qualify for the seven year depreciation instead of the thirty-nine year depreciation allowances.

To fully appreciate the benefits of designing and building your facilities so that they qualify for seven-year depreciation, **Table 2** shows the positive impact on cash flow that occurs if your project is demountable. The cost, revenues and expenses associated with this table are the same as the previous illustrations

### Conclusions

Graph A illustrates the positive impact on annual cash flow that results from constructing a modular project. In essence, as illustrated here, the after tax cash flow increases by 30 percent in the first seven years just by qualifying for the seven-year depreciation allowance. The numbers are compelling and clearly speak for themselves.

What remains is for mini-storage developers and operators to familiarize themselves with new and viable alternatives to traditional construction which so greatly enhances a mini-storage facility’s operating performance that cannot be ignored.

The auditing firm of Hansen, Barnett, and Maxwell of Salt Lake City, Utah, has reviewed a mini-storage park using this type of building system. The firm believes the project qualifies for the depreciation allowance provided in Section 1245 (a)(3) of the Internal Revenue Code.

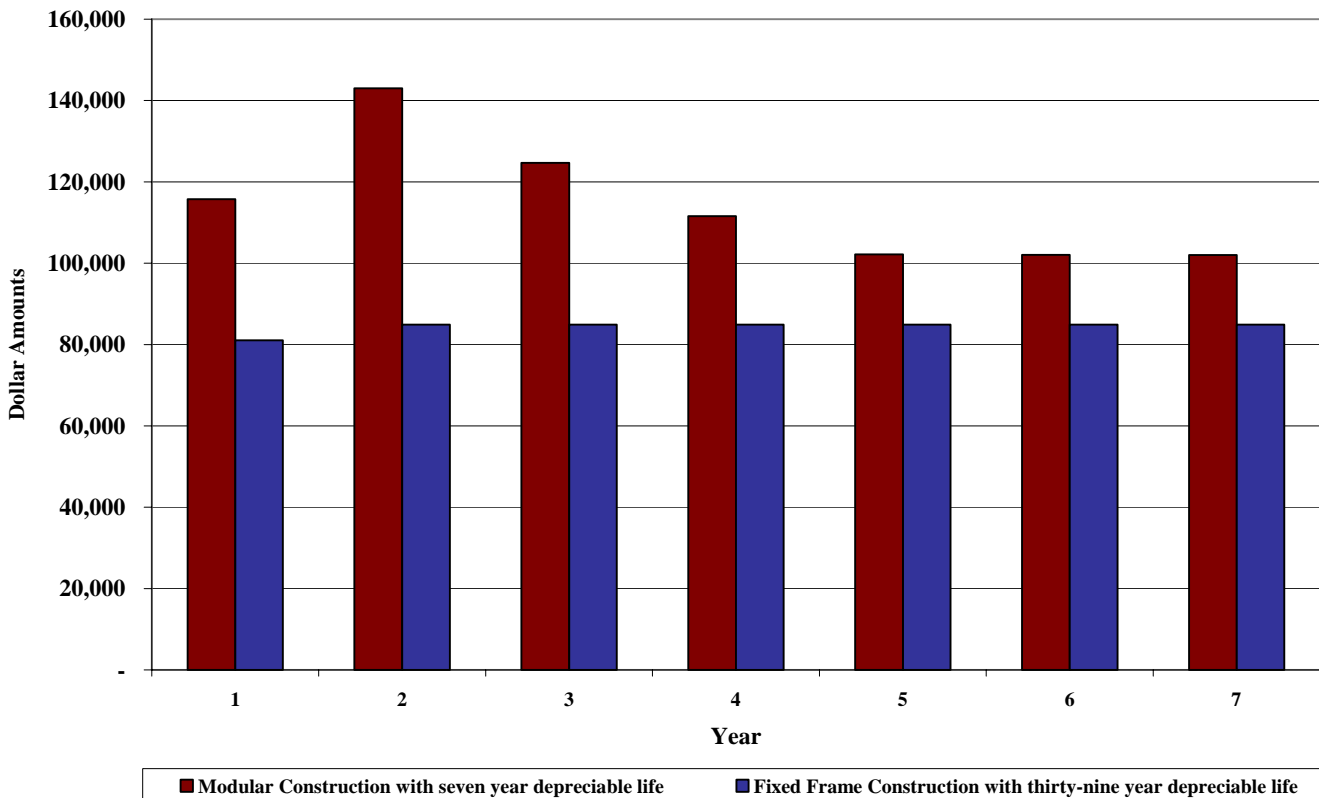
### Assumptions

Project Cost	
Land	\$250,000.00
Improvements (Foundation)	\$50,000.00
Development and construction costs	\$741,195.00
Development and construction cost for each scenario \$21.00 per ft <sup>2</sup>	
Rentable square feet	35,295
Average rental rate per square foot	\$0.60 per month
<i>* No rental rate of operating expense increases during the term of analysis.</i>	
<i>* No debt service is included in calculating operating expenses or cash flow.</i>	
<i>* No sales tax is included in operating expenses.</i>	
<i>* Depreciation for the building system is calculated on a seven year, double declining balance, half year convention.</i>	
<i>* Depreciation for the building system foundation is calculated on a fifteen year, double declining balance, half year convention.</i>	
<i>* Depreciation for the fixed frame building including the foundation is calculated on the thirty-nine year straight line basis.</i>	

Additionally, Their research identified three cases that lend support to the argument that the building systems term is tangible personal property for federal tax depreciation. You should consult your own tax advisor with respect to your own facility and construction.

Graph A

Cash Flow After Tax





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## FEATURING:

- Tax advantage depreciation resulting in increased “after tax” cash flow
- Durability, aesthetic appeal and low-maintenance
- Less construction cost when compared to traditional methods
- Structural flexibility for expansion
- Demountable installation for ease of relocation
- Substantially reduced construction time from traditional building methods



**For MAXIMUM “after tax” cash returns on your investment and to gain the competitive advantage of demountability, contact MD BUILDING SYSTEMS:**



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