



Sales Tax – A Double Demon?

It Could Cost A Lot More Than 6%

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by Michael L. McCune

A few years ago, I commented on states like New Jersey and Connecticut attempting to enact a law that requires sales tax be charged on self storage rentals. I predicted that this might become a trend. Unfortunately, I was right. There are now several states – and the number is increasing – with sales tax being charged on self storage! With this trend now well established, I thought I would revisit the topic of sales taxes and renew my “call to arms” by the National and State Self Storage Associations to fight the sales tax issue. If you think you know all about the harm sales tax creates, take a look at the last paragraph and see what you think about the consequence.

THE OBVIOUS IMPACTS, VERY COSTLY

The most obvious impact on self storage is that, despite what anyone says, the price of the product just went up by 6%. The good news, if there is any, is that at least your competitors are equally affected. However, that is as close to good news as we are going to get in this little missive on sales taxes. The first negative impact is that the value of the facility just went down by the amount of sales tax that you can’t pass along without reducing your rental rates or occupancy. Let us take a look at an example and see what this law could do the value of a property. For the sake of argument (and economists tell us this is the right assumption in the long run), because our market is competitive, we cannot pass along any of the sales tax.

In our example, the 6% decrease in revenue as a result of the sales tax translates into an \$18,000 decrease in Net Operating Income. When valued at an 8% cap rate, the resulting value of the property decreases by \$225,000, or a 9% drop from the property before sales tax. This is truly an

	Before Sales Tax	After 6% Sales Tax
Revenues	\$300,000	\$282,000
Operating Expenses	\$100,000	\$100,000
Net Operating Income	\$200,000	\$182,000
VALUE @ 8% Cap Rate	\$2,500,000	\$2,275,000
Value Reduction	\$225,000 or 9%	

impressive number, and it exceeds our intuitive notion by 50%. It is clear that higher prices (and that is ultimately what

sales taxes are) also reduce the total demand in the market. If the demand had been there at the higher prices, you would have already raised your rates! It is hard to measure this impact – economists call it measuring the slope of the demand curve – but it wouldn’t surprise me that it is almost 1% of lost demand for each 1% of price increase. To put this in perspective, think of it this way: how many customers would you have if you doubled your rates? That is the same ratio I suggest. Thus, in competitive markets the total occupancies could be reduced in addition to having the revenue per unit reduced!

THE LESS OBVIOUS, MORE COSTLY

The reason that Connecticut and other states such as New Jersey and Michigan attempt to enact sales tax laws is two fold. First, the state needs the money (states and cities always need money).

Second, the politicians know there aren't many self storage owners in the state (and many are from out of state) and that they won't face a revolt at the polls. If they try it on apartments, armies of both landlords and tenants would be screaming at their elected representatives. Other real estate landlords are also better campaign contributors than self storage owners and thus may not suffer as much. Unfortunately, besides being in fiscal trouble, the states also talk amongst each other and will probably find that other states' success in instituting a sales tax on self storage would be attractive to them.

THE REALLY BIG REASON TO FIGHT SALES TAXES

Although the direct economic consequences are severe enough, there is a more draconian impact and that is on the attitude of planning commissions and city councils. In the past, we have thought that planners and cities were reluctant to approve new self storage facilities just because they were ugly. However, my experience and that of my private sector planning friends would indicate that there has been an unspoken bias against self storage because it doesn't pay sales tax. The bias is always unspoken because to consider sales tax revenue is either politically incorrect and, in some cases, against the law. Combine the need for revenue by local governments and the fact that self storage would pay a sales tax and you will find that this might cause a lot more sites to be deemed appropriate for that use. Clearly, this could have an impact on potential overbuilding in many markets that have long been considered politically off limits. I recently heard a story where a developer's project was considered not appropriate by city planners and he "resolved" the city's reluctance by agreeing to pay a "use fee for infrastructure" in an amount of 5% of gross revenue (sales tax by another name). Apparently, aesthetics became less important after the planners "understood the project better." This unintended consequence may well be the most significant to many owners.

In summary, it is time to gather the force and fight sales taxes. If you want to get involved, visit www.selfstorage.com for a contact list of state self storage associations. Both the National SSA and the State Associations should spare no efforts in this battle.

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