



Commercial Real Estate

By Stephen A. Cross, CCIM

Business Condos: A Closer Look

Obsessive Leasing Disorder, also known as OLD thinking, was prevalent among medical practitioners and small-sized business owners until commercial condos became widely available in the late 1990s and early 2000s; a period when rents started to climb and interest rates fell. Developers took advantage of readily accessible sources of money and found a logical use for small parcels of land. In many areas, existing buildings were converted into condominiums.

The result has been a supply of 1,500 square foot to 8,000 square foot spaces that, in some parts of the country, has far exceeded demand. Thanks to this abundance of affordable property, almost every medical, office, industrial and retail user can now own their building, or a piece of a building. This article will offer insights to some of the factors owner/users should consider when deciding whether or not to invest in a business condo.

Flexibility vs. Stability. Generally speaking, leasing affords flexibility. However, as lease rates escalate regularly, the ability to relocate and/or quickly right-size comes with an ever-increasing price tag. Buying the building that houses your business helps ensure long-range stability. Therefore, for those who can plan their space needs for the next five years, and who do not need the down payment amount to operate or grow their businesses, owning a business condo or building should be part of a balanced business plan.

Benefits of Owning. In addition to having pride of ownership, benefits of owning your own building include: 1. The ability to control the costs of occupancy. 2. The drastic reduction in occupancy costs when the mortgage is retired. 3. Real estate is an asset that can be sold or leased to others. 4. The buildup of equity can be used to generate cash through refinancing.

The Down Payment. For many people, the greatest obstacle to buying real estate is finding a way to accumulate the down payment, typically ten to twenty percent of the purchase price. An effective method my clients use is to "lease for less and invest the rest." That is, invest the savings realized from leasing concessions and below-market rental rates in low-risk, interest-bearing instruments (money market accounts, bank CDs with short maturity dates, and the like). Earmark the account(s) for the day when the right buying opportunity presents itself.

Lease with the Option to Buy. A lease-option is a unilateral contract that gives the tenant the right, *but not the obligation*, to purchase the premises. During periods of oversupply, many condo developers are willing to lease space in an improved condition, agreeing to sell the unit to the tenant at a future date. Cash-strapped tenants can then use the lease period to accumulate the down payment amount. *Strategies:* Be certain to negotiate a firm purchase price as part of the lease negotiations. You may also be able to apply some or all of the lease payments towards the purchase price. In any event, the purchase price, rental rates and concessions should reflect the current market conditions.

Improvement Costs. If a condo is purchased in an unimproved

condition, outfitting costs can range from \$50 to \$60 per square foot for a typical office build out, to well over \$100 per square foot for a medical, dental or high-end office build out. Note that many lenders will include the cost of improving a space in the amount to be financed. A few words of caution: Do not underestimate the time it will take to build out a space. Also, just as in renovating a home, it's generally more costly than anticipated (and budgeted). *Strategy:* Play the waiting game and be the "second man in." That means purchasing a previously occupied space – one that has been improved. Chances are, all you will need to do is repaint, install new floor covering and perhaps move a wall or two...all relatively inexpensive improvements.

Ongoing Expenses. In addition to the mortgage payment, owners of commercial condos pay the same types of ongoing expenses as do owners of residential condos. These include association dues and the operating expenses of the property, which typically consist of property taxes, casualty insurance, common area maintenance, electrical usage and janitorial expenses. Additionally, owners are generally responsible for the cost of maintaining their HVAC (heating, ventilation and air conditioning) systems.

Signage Considerations. One of the perks of owning a building is the ability to brand it; that is, to place your company name on the building, something most small tenants cannot do in leased space. But, condo associations and the city can restrict the size, color, style, location and number of permitted building signs – so read the sign criteria to determine what signage is allowable *for your unit* before closing escrow. This can typically be accomplished during the due diligence, or feasibility, period. Also, read the CC&Rs carefully to confirm whether real estate signs (those mini-billboards in front of most buildings) are permitted on the property and where they can be located; this could become critical if you wish to sell or lease your unit.

Be Proactive. Ownership of a business condo comes with the opportunity to become involved in the management of the property, so join the Board of Directors, or at least attend the meetings and let your voice be heard.

Closing Comments. In the long run, commercial real estate should be viewed as a significant source of retirement income for you and your family. With an education on the mechanics of leasing space and buying property, an understanding of the nuances of the market and the support of experienced advisors who have a duty to protect the interests of you and your business, there is no reason why every business owner and small- to mid-sized investor cannot enjoy the benefits of owning commercial property. After several years of minimizing rental expenses, methodically saving, and being on the lookout for buying opportunities, I, and many of my clients, have been able to purchase our own office condos. So can you. ■

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