

BUYING COMMERCIAL BUILDINGS AND SPACES

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The logical steps to helping you, the private
business owner, become your own landlord.



Palisades One

Table of Contents

Chapter One:	The Different Approaches To Ownership	<u>Page 1</u>
Chapter Two:	Getting Prepared to Look For Buildings and Spaces	<u>Page 3</u>
Chapter Three:	Maximizing Your Buying Opportunities	<u>Page 5</u>
Chapter Four:	Making Initial Offers	<u>Page 7</u>
Chapter Five:	Making an Offer To Purchase	<u>Page 9</u>
Chapter Six:	Inspection Period and Due Diligence Activities	<u>Page 12</u>
Chapter Seven:	Financing	<u>Page 18</u>

Chapter One: The Different Approaches to Ownership

If you have decided that you would rather own the real estate for your business, then you first need to consider the different ways to approach ownership. Every form of commercial real estate, including office, flex, retail, medical, or industrial real estate, can be purchased in several different ways. The four most common approaches to buying a building or space you need for your business can be described as follows:

Commercial condominium space

These are multi-tenant properties that have condo units you can purchase. These properties have an owners' association that is responsible for general maintenance, landscape maintenance, common area lighting, common area property taxes, etc. By sharing these expenses and having a property management company taking care of the property and the business matters, this type of ownership can be very simple. You can buy just enough space for your business, or buy extra space and lease a portion of it out until your company needs the space, or keep the rented unit/s for long-term rental.

Freestanding buildings

This is what many business owners think of first when ownership is considered. You simply own your own building on your own lot. You don't have neighbors within the building, and you can maintain the property however you like.

Multi-tenant buildings

You can buy a building containing a variety of tenants, occupy the space you need, and keep the other tenants for income and/or expand into their space as your business needs it. You can also convert a multi-tenant building into a commercial condominium and keep the other spaces rented or sell them. Most business owners do not consider this approach.

Convert a building into a commercial condominium

This approach is frequently overlooked. We are in the midst of this situation right now for two customers. We found a 57,000-square-foot vacant building

and are converting it into three condominium spaces. Each of our customers will own and occupy one-third of the building and will be partners on the other third of the building, which they will rent or sell to another company.

Once you have decided that you want to buy a building or space and have decided which of the four approaches best reflects the type of transaction you are most interested in, prepare to look for properties.

Chapter Two: Getting Prepared to Look for Buildings or Spaces

Review your lease

Double-check your lease expiration and whether there is renewal or holdover language. You ideally would like to be on a month-to-month lease while you try to find a building or space to buy.

How much time is needed?

Ideally, you would start this process while you have one year left on your current lease, but you may have more or less time on your lease. If you have a year or more on your lease, you can ask your landlord if you can get out early. Your landlord will probably not want to provide you with this flexibility, but you can always ask. Also, don't forget your neighbors within a multi-tenant building may need your space. If you have less than one year remaining on your lease, your timing may be perfect, but it would not hurt to know if you could go month-to-month when your lease expires. However, if you tell your landlord that you want to leave to buy your own building, your landlord may push very hard for an extended lease renewal contract.

Review your lease renewal clause

You can't assume you remember exactly what your lease says. Frequently we have customers who have the wrong interpretation of their lease. Your lease may have an automatic renewal clause or other language that you just don't remember. You should ask us to review your lease.

Look at your holdover clause

Most leases have specific language as to what happens if you don't renew your lease and stay in your premises beyond your lease expiration. The holdover clause may state that the lease converts to a month-to-month lease whereby either party may cancel with as little as 30 days' notice. Holdover clauses also address the rental rate. Landlords do not like tenants to be in holdover. Therefore most holdover clauses call for the rent to escalate. We have seen holdover clauses call for the rent to escalate by as much as 200%. There is no need to make a mistake. Let us read your lease.

Hire a commercial agent

You don't have to do this, but it is highly recommended. About 95% of the commercial properties on the market are listed by a commercial agent. If you have your own agent, he or she will simply share or split the commission offered by the selling agent. We at Palisades One can help you with this or you can use another agent. We simply suggest you get referrals and conduct a formal interview process. Most buyers just start working with any agent that they know or bump into. Do your homework. You may be looking at spending \$1,000,000 dollars or more, so find the best agent you can to represent your interests.

Establish your geographic parameters

Meet with your agent, get out a map, and talk about where you are interested in buying a building or space. You want your parameters to be as broad as possible, but there is no need to look at properties in locations you ultimately will not accept. Draw on the map so that you and your agent both know the targeted area as well as how far in every direction you would consider for your next business address.

Determine the amount of space you need and how much space you would consider buying

This is not as simple a question to answer as you may think. Your business may need 10,000 square feet now but may need 20,000 square feet in the future. You may want to look at buildings as small as 10,000 square feet that are expandable, or you may want to look at buildings as large as 50,000 square feet that are multi-tenant. Furthermore, you may want to look at buildings that are not subdivided but can be subdivided for you to lease or sell the extra space. Depending on how much capital you want to invest, the parameters of your search could vary greatly. You don't want to hear about the great deal that got away because you and your agent did not discuss this topic.

Chapter Three: Maximize Your Buying Opportunities

Reach out to the market

When it's time for us at Palisades One or your agent to start looking for space, you should stay involved in the process and plan on meeting at regular intervals to discuss market opportunities. At these meetings, you want to find out what methods are being used to find your next building or space.

Maximize the number of properties that fit your needs

The goal of us at Palisades One or your agent is to find as many viable properties as you can that fit your and your business's needs. The more opportunities you identify that fit your needs, the better deal you are likely to find. The different ways to find available commercial properties are as follows:

- **CoStar.** This is the premier subscription-only commercial real estate database used by thousands of brokers around the country.
- **Xceligent.** Premier subscription-only commercial real estate database used by thousands of brokers.
- **Pairlist.** This is an email server with over 800 members on which agents and landlords regularly post commercial real estate properties available for sale or lease and also where agents post property buying and leasing requirements. Pairlist is free, and we at Palisades One are members.
- **Triangle Commercial Property Exchange.** This is similar to TCAR. Triangle CPE is an email server for available properties and current needs but is also trying to establish itself as a database for available properties that facilitates searching for commercial real estate. We are members of Triangle CPE.
- **Loopnet.** This is the largest database of commercial properties in the United States. This service is available on a limited basis to anyone although many commercial real estate brokers will pay for an

upgraded membership. Although this is expensive, it is a very good service. As premier members, we would be more than happy to access this data base for you.

Driving your targeted area. We drive your targeted area with you on a regular basis for three reasons.

1. We both should be looking for buildings that appear to be what you're looking for and have signs on them showing their availability.
2. We need to drive your targeted area during the day and be on the lookout for buildings that appear to be vacant or close to vacant (few to no cars in the parking lot). Do not overlook this approach. This approach just led to the best deal of our careers for one of our customers wanting to buy a building in Morrisville. We were driving the area and saw a building with no occupants whatsoever. Upon further investigation, we found that the owner was donating the building to Duke University. The recipient Duke University sold the building to our customer at a very attractive price.
3. While driving your targeted area you may see other properties that seem to be overcrowded or simply appear to be exactly what you're looking for. We are more than happy to call on any property that looks as though it may come on the market.

If you are driving your targeted area and you spot the perfect building or space, be courteous and tell us at Palisades One or your agent to make the call. If you are working with us or have a good agent, you need to recognize that he or she works on commission, and if you call direct to the property owner or listing agent, we or your broker may have a hard time getting paid.

Chapter Four: Making Initial Offers

Unlike leasing, buying a building or space involves the buyer initiating offers. Commercial properties listed for sale are likely to have an asking price. In leasing, the landlord or the landlord's agent proposes lease terms for you, but in buying a building or space, you are most likely going to need to make an initial offer.

Don't be bashful—make initial offers

Making an offer on a commercial property should be handled very carefully, but typically your initial offers will be low and they should be non-binding. Frequently the initial offers are made verbally or via email by us or your agent. The initial offers are only tendered to get a feel for what the seller may ultimately accept. These initial offers are to get the seller to show his or her cards so that you have an idea of the price range for the specific property.

What should be included in an initial offer?

These offers need to be non-binding, they should be made by us or your agent, they can be verbal but ideally they would be made via email, and they should always address how much time you may need. You do not want to get close on price just to find out you and the sellers have totally different timing expectations. Therefore these offers should be in person, on the phone, or in email and should address the primary terms and conditions of what you may ultimately agree to in an "offer to purchase contract." These initial offers should come from us or your agent, not you, and they should be worded something like the following:

"My customer John Smith, owner of the XYZ Company, is interested in the 1609 Park Place building. I think he is interested in paying \$1,000,000 for the property and would need 60 days for his inspection period and would then need 60 days to close. This is a non-binding offer, but this is what I think he is willing to offer."

At this point you have not even made an offer—you are simply getting the ball rolling towards finding out what some of the sellers are prepared to accept. Remember, the market is currently soft, and these initial offers are to help you find out who is the most motivated to sell. These initial offers are

the key component in helping you find the best possible deal. Don't be afraid to have your agent make these offers, as they are non-binding.

Chapter Five: Making an Offer to Purchase

When you have identified the building or space that you want to buy, it is incumbent on you, your agent, and your attorney to prepare and submit an offer to purchase. The agent is instructed by the North Carolina Board of Realtors to only use a standard bar form contract. Your agent is not allowed to write legal language; therefore you may need the help of a competent commercial real estate attorney. Some of the clauses, terms, and conditions that you want to make sure are adequately addressed are as follows:

- **Purchase Price.** We think this is the one clause that needs no explanation.
- **Earnest Money.** Frequently this is approximately 1% of the purchase price but can be for any amount of money that you want to dictate within the contract. We typically recommend that this clause additionally addresses that it will only be paid if there is acceptance of the contract and that the earnest money check will be delivered within three days of acceptance. Your contract should also address who will hold your earnest money. We always recommend that your attorney hold the earnest money.
- **The Inspection Period.** This is the time period during which you can investigate the property and during which your earnest money is refundable. You want your contract to clearly address that during the inspection period you can cancel your purchase contract for any reason whatsoever or for no reason at all and receive a prompt repayment of your earnest money. You want this to be crystal clear. You also may want a provision that extends the inspection period if any number of identified issues uncover a problem with buying the property.
- **Seller's Information Clause.** You want it incumbent on the seller to provide you with all information the seller has in his or her possession that pertains to the subject property, including but not limited to: surveys, building plans, roof warranty, HVAC information and maintenance contracts, tax bills, utility bills, leases, or any other information that is in the seller's possession.

- **Clean Title and Title Search.** Ask the seller for his or her most recent title policy and have your attorney fully investigate the title of the property during your inspection period. Your seller's title policy will reduce the cost of your attorney's obtaining title insurance for you. Many professional agents and attorneys perform title investigation just prior to closing, and we think this is a mistake. If there is a problem with the title to the subject property, you want to know this before your earnest money becomes non-refundable. Depending on whether or not there is a problem with the title, you may want to extend the inspection period until that problem is resolved.

- **Right of Entry.** You want a clause that addresses that you will receive keys as soon as possible and that you have the right to install a lock box on the building. This clause should further state that you, your employees, vendors, subcontractors, and any of your invitees can enter upon and inspect the subject property and that any damage or injury is your, not the seller's, liability. You may want to discuss this issue with your insurance agent.

- **Seller's representations and warranties.** Ideally this clause is created to force the owner to clearly represent there are no problems with the property prior to your purchase, but some seller reps and warranties should survive closing. Some of the more common seller representations and warranties are as follows:
 - Seller warrants that he and or she is the sole owner of the property and there are no other owners of the property, and that seller has full legal right to sell the property.
 - There are no legal actions or legal proceedings affecting the property.
 - There is no pending or contemplated condemnation.
 - The property is not in a flood zone.
 - There are no special assessments on the property.
 - The property is free of hazardous substances.

- There are no graveyards on the subject property.
 - The seller is not a foreign entity.
 - The property is within governing compliance for buyer's intended use.
 - To the best of seller's knowledge, the property has clean title.
 - There are no encumbrances or easements affecting the property.
- **Entire Agreement Clause.** This states that any and all issues relating to the contemplated purchase are within the agreement, and if there are any changes they must be in writing. This clause will then go on to say if there are any material changes to the terms and conditions of the contract, those changes must be in writing.
 - **Buyer's intended use.** You want your contract to clearly state that buyer's intended use is for (describe your use) and that seller has no knowledge or information that would lead to the conclusion that this property cannot be used for (describe your use).
 - **Broker's Commission.** The contract needs to clearly state that the buyer and seller recognize one or more agents and their specific commissions within your purchase contract. This clause needs to further state that you, the buyer, are held harmless for any additional commission claims that are above and beyond what is disclosed within the contract. This puts the burden on the seller in the event some other broker thought he or she was entitled to a commission.

These are just some of the clauses that should be double-checked prior to signing a purchase agreement. You need to be represented by a competent commercial real estate attorney prior to signing a purchase contract.

Chapter Six: Inspection Period and Due Diligence Activities

Your purchase contract is executed when both parties have signed the contract. Your inspection period is typically a number of days beyond the execution date or is a specific calendar date. Either way, you need to make sure you and the seller and the seller's agent have all agreed to the exact day the inspection period ends. If your contract stated 60 days from full execution and the seller signed the contract three days after you, someone needs to get out a calendar and send an email to all parties stating the day of the week and the date the inspection period ends. Typically, if it is a Saturday or Sunday, then the actual date would be Monday at 5:00 pm.

Due Diligence Checklist

Seller Information

Name
Company Name
Address
Email Address
Telephone Number
Mobile Number

Selling Broker's Information

Name
Company Name
Address
Email Address
Telephone Number
Mobile Number

Your Broker's Information

Name
Company Name
Address
Email Address
Telephone Number
Mobile Number

Attorney's Information

Name
Firm's Name
Address
Email Address
Telephone Number
Mobile Number

Contract Execution Date

Inspection Period Ending Date

Closing Period and Closing Date

Seller's Title Policy Obtained

Title Search Completed

Operating Expenses for the Property

- Last three years' tax bills
- Last three years' electric bills
- Last three years' gas bills
- Operating expense ledger for the property
- Summary of repair or improvement expenses
- Any property owners' association expenses

Building Condition

For the following items you can use a commercial property inspector. What we often do here at Palisades One is hire independent vendors to investigate portions of the building or space you may buy that are within their field of expertise. Frequently the independent vendors have more expertise than a building inspector.

Roof warranty information

Is a copy of the roof warranty available? What is the age of the roof?
Has the roof been inspected by the initial installer? And lastly visit the property during a rainstorm.

Structural information

You may need a structural engineer to investigate the building.

Electrical systems

- Age
- Condition
- Capacity
- Changes needed

HVAC system

- Age
- Maintenance information
- Maintenance provider
- Condition
- Repairs needed

Plumbing inspection

Have a plumber inspect and use all plumbing facilities and inspect them for needed repairs.

Parking lot inspection

Will the parking lot or truck court need sealing, repair, or resurfacing? Depending on what you see during inspection, you may need minimal or extensive repair.

Environmental assessment

Get a copy from the seller of any environmental report he or she has. Then you need to have the environmental assessment updated or have a Phase One investigation provided by an environmental firm that is working for you.

Soils investigation

If you plan on expanding the existing building, you need to investigate the soil condition of the areas that will undergo any construction activities, even if you are just adding outside storage or additional parking or truck court areas.

Zoning compliance

Meet with the governing municipality or any governing agency to determine if your use is allowed within the property's existing zoning and whether there are specific zoning conditions that affect the subject property.

Transportation issues

Find out if there are contemplated road widening or sidewalk projects planned for the subject property. If you will be adding on to the subject property or needing a permit for interior renovations, you may be surprised that the municipality may want you to make substantial improvements to the property. A road widening project for a property located at the intersection of two roads could easily cost \$250,000. It pays to do your homework.

Storm water issues

You may want to tour your property during a rainstorm to see if you have any storm water issues that are not obvious during dry weather conditions.

Storm water ponds

In Wake and many of the surrounding counties, a pond is required to capture contaminants when it rains. If you are going to make substantial improvements to a building that will require permits, you may trigger the need for a storm water pond. These ponds can cost as much as \$75,000.

Sprinkler system testing

If the building has a sprinkler system, you are likely going to want to have it tested to determine if the sprinkler system has adequate capacity for your intended use.

Is a sprinkler system needed?

If you plan on stacking material more than 12 feet high within your warehouse or production area, you will need your space to be sprinklered. A sprinkler system, depending on the size of the building you are buying and the capacities of the system needed, will likely cost as much as \$3.00 per square foot.

Other Issues

If you have investigated all the above issues, then you have likely found additional issues that need further investigation.

Chapter Seven: Financing

Most business owners do not realize that the financing to buy a building or space is actually easy to obtain. Yes, as a nation and within the banking industry we are in the midst of the lowest interest rates ever. The one loan that is most desirable to a bank is an owner occupied loan. Owner occupant lending is going on every day, and most banks are interested in these loans.

Owner occupant lending is considered one of the safest of all lending practices and typically is the most profitable loan for a bank. The reason that it is profitable is that owner occupant loans have a low default rate, and when these loans are made most banks will try to get the balance of your business accounts.

The Two Most Common Types of Owner Occupant Loans

If you are trying to get financing for your new building or space, there are two primary means to obtain financing.

1. A conventional bank loan: Many business owners just go to their bank and ask what amount of lending their banker thinks they and their business can afford. Your current banker will provide you guidance as to what he or she thinks you can afford. Generally speaking, a bank loan will require a down payment of 15% to 20% of your total costs for the building or commercial space and the necessary improvements and other costs.
2. A Small Business Administration (SBA) loan: This type of loan is offered by bankers as well as SBA lenders. The loan is quite simple, and it requires a participating bank. The down payment is only 10% and the balance of the money is provided 40% by the bank and 50% by the SBA, a division of the federal government.

We can help you get ready to pursue financing and regularly help our customers with this activity. By helping you identify all costs associated with your contemplated transaction, our help can minimize how much out-of-pocket expense you and your business may incur. We have financed over \$100,000,000 of transactions and are considered to be as competent regarding this subject as anyone you can find here in the Triangle. Most bankers know us and welcome our involvement.

The Financial Information That Will Be Required by a Bank or an SBA Lender

Personal and business financial information

We are in a time period in which bankers are as thorough as ever before. We are also in the information age, so whatever information a banker asks for, you will need to provide it. Whether you are dealing with a banker you know well or you will be entertaining multiple banks, some of the information they will ask for is as follows:

Minimum of three years' personal tax returns

Minimum of three years of your business's tax returns

Your personal financial statement

Unless you want your wife to co-guarantee your loan, which we do not recommend, then your personal financial statement cannot have any joint assets.

Liquidity verification

Whatever liquid assets or stock accounts or retirement accounts you show on your personal financial statement will need to be verified. Typically the most recent copy of a statement for the given account will be adequate.

Financial statements for your business

- A minimum of three years' profit and loss statements
- A minimum of three years of balance sheets

Business projections

Your banker wants to know that your next year or several years look good. You will need to provide some sort of projections, and most likely you already have this information.

Personal biography

Sometimes a banker will ask for a narrative explaining your education and past work experience.

A narrative of your business

A page or two explaining what your business does, who or what industry your business serves, and how your business turns a profit, may be required.

Contingent liabilities

If you own other assets that have debt, the banker will ask for an asset by asset breakdown of each individual asset, its current value, and what the terms and conditions are of the debt that is collateralized by that particular asset.

Once all this information is provided, the banker is likely to ask for more information regarding any number of specific topics. Don't be surprised if this effort takes six to eight weeks. Banks are trying to be careful and want to make owner occupied loans, but they want to get to know you well to determine how much risk is involved in lending you money for your building or space. Your best bet is to start this process early.

Information Required for the Real Estate Transaction

Whether you are buying a building or a commercial condominium space, you need to recognize that the bank wants you to have all your information ready and your financial needs thoroughly addressed. If your bank decides to lend you money and produces a loan commitment, and then your costs exceed the loan amount, the banker would rather you pay those costs out of pocket than go back to the loan committee and address why the costs are higher than planned for your commercial real estate loan. If your down payment is 10% to 20% of the purchase and improvements, then for every dollar you miss you will be paying 80 to 90 cents on the dollar for those expenses out of pocket. It pays to be thorough, and it pays to have the right team of professionals helping you. The items and their associated costs should be as follows:

Purchase price

Hard costs above the purchase price

Hard costs refer to anything that is a physical addition, improvement or repair to the property that you are buying.

- Breakdown of costs for repairs
- Complete expense budget for building expansion
- Any costs associated with interior improvements and any costs that represent capital improvements

Soft costs

You should ask your attorney for a comprehensive budget for all legal expenses associated with buying your building or space. Let your attorney know that it is important for you to have a comprehensive budget and that you want to stick to the budget. Ask if he or she foresees any items that will create costs to you for additional services. Some of your legal expenses and other soft costs will be as follows:

Legal expenses for setting up a separate LLC or ownership entity

Legal expenses for any condominium documents

Legal expenses for title search and any further title investigation

Legal expenses for deed preparation

Property taxes for partial year

Revenue stamps

Deed preparation

Origination fees charged by the bank or SBA lender for consummating the loan

Environmental fees—your lender will likely ask for at least a Phase One audit of the property to ensure that there are no environmental problems. If any problems arise from the Phase One audit, your lender may require a Phase Two audit as well as ground water testing.

Inspection or material testing expenses

Soft costs associated with preparing to obtain any permits

If you will be making substantial improvements to your building or space, you will have expenses associated with those improvements. You will likely need architects and engineers to adequately prepare for any permits required by the governing municipalities and agencies.

Architectural Fees

These would be for any drawings needed to make improvements to the interior or exterior of the property.

Engineering fees including but not limited to

Mechanical engineering for your HVAC system

Plumbing engineering for any additions to the water or plumbing service within the building or property

Electrical engineering for any additions or changes made to the electrical system within the building or property

Engineering, design, or testing of the building or spaces sprinkler system

Permitting expenses

Depending on what improvements you are making to the subject property, you are likely going to need to get permits. These expenses vary in cost and scope depending on the extent of the improvements and the municipality that you are working within. You or your architects, engineers, or contractor needs to meet with the municipality and clearly identify what activities need permits and what the costs of those permits are.

Conclusion

As you pay yourself rent and pay down your mortgage, your building could become a big part of your retirement. By using all of the best financing and tax techniques, your net worth can grow at a surprising rate.

Make sure to ask us about all financial and tax issues so that we can help you and your accountant maximize the earnings that your building can create.

We hope the information in this eBook is helpful to you. We use sections of this book as checklists while we help our customers buy buildings or spaces.

If you think we missed anything, please let us know. We like to share information and believe that when you share you get a lot in return.

If you have any questions or comments, please give us a call.

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