



## Insider Tips for Leasing, Buying, and Investing

This is a companion to an earlier article which focused on the critical decisions and factors to consider before purchasing commercial property, and the seldom-discussed factors that can affect the price of commercial real estate. (See “Lease or Buy?” in the Articles section at [www.crossrealty.com](http://www.crossrealty.com).) In this column I address some of the subtleties of leasing, buying and investing in commercial property.

**WHEN TO LEASE:** Leasing is generally best suited for those businesses that have space requirements which may materially change within three to five years; require a location which is only available as part of a larger development; have not yet accumulated a down payment fund; or whose ownership believes they can achieve a greater return on the down payment amount either by growing their business or in other types of investments.

**NEVER PAY ASKING RATES:** While asking rates fall within a narrow range, the getting rates can vary widely. That’s because some landlords have a greater urgency to lease space than others. The most accommodating landlords are generally those with mortgage obligations, significant vacancies, either current or anticipated, and/or those wishing to sell their property. Each group can be expected to grant generous concessions, including a reduction in the rental rate (typically five to ten percent), free rent (one month free for every year of the lease term) and a reasonable tenant improvement allowance (\$3 to \$10 per square foot).

**SUBLEASES CAN BE BARGAINS:** Businesses with short-term needs (two years or less) should consider subleasing space. As the original tenant probably received inducements when signing its lease, don’t be shy about negotiating rental concessions, including a discounted rental rate and a period of free rent. If the termination date of the sublease is not adequate for your needs, you may be able to negotiate a longer lease period and favorable terms directly with the landlord. In this instance, the original tenant may be permitted to terminate its lease in exchange for subsidizing some or all of the landlord’s re-tenanting costs, including the recapture of any unearned commissions.

**OPTIONS TO PURCHASE:** For businesses leasing space for terms longer than five years, and those that must incur significant expenses to improve a property (are you listening, doctors and dentists?), it would be prudent to negotiate the option and/or first right to purchase the building or, in the event the property is ever converted to business condominiums, the portion of the building being leased. I also suggest negotiating a not-to-exceed purchase price - which should be capped at the appraised value of the property at the time the option is exercised.

**BE PREPARED TO BUY:** Even before your business has established itself as a viable going-concern, consider owning the property that houses your business, or several businesses. As real estate markets are cyclical, learn to identify when periods of excess supply exist, and be poised to take advantage of favorable financing opportunities. In the long run, commercial real

estate can be a significant source of retirement income for you and your family.

**SELLER FINANCING:** The principle advantages of seller financing, a carryback, to the buyer are to save the costs of borrowing money and the ability to complete the transaction in a matter of days, rather than the weeks or months it typically takes for conventional underwriting. I suggest shopping for money before discussing a carryback with the seller. Once the range of interest rates and terms available from commercial lenders is known, pose the best terms to the seller. While the popular industry thinking is that you will generally be able to negotiate either price or terms...your goal should be the lowest price and the best terms.

**INVESTIGATE BEFORE INVESTING:** The primary reason investors acquire real estate is for the stream of income it will produce, and not necessarily for the property’s physical attributes (i.e., location, curb appeal, and the like.) To the detriment of their clients, few real estate agents, bankers, accountants or financial planners are familiar with the techniques necessary to accurately assess investment property, and focus on “cap” rates when discussing price, without regard to the risks involved. Financial tools such as the discounted cash flow analysis (DCFA), net present value (NPV), and internal rate of return (IRR) should be used when evaluating, measuring and projecting future performance. Anyone contemplating the purchase of income property would be well-served to retain proper representation to help establish their risk, return and leverage criteria before they look at properties.

**PRICE DOES NOT EQUAL VALUE:** Factors that affect the value of investment real estate also include the *quality* of any tenants and their lease terms, the *current* condition of the property, and the *verifiable* net operating income (NOI). Disregard questionable assumptions about so-called up-side potential...pay only for what exists today. Also, be aware that property owners wishing to bolster their rent rolls and support an inflated asking price have been known to grant significant “off balance sheet” inducements to tenants willing to pay top dollar rents. So interview each tenant and confirm, in writing, what concessions were granted and whether they intend to remain in the building. If you decide to pay for tomorrow’s anticipated revenue stream today, require the seller to guarantee the projected rents for at least 12 months.

**CLOSING THOUGHTS:** Decide early on that you intend to make fully informed decisions...and have the patience to wait for the right circumstances to make the right deal. This means taking the time necessary to become educated about the realities of commercial real estate, and choosing experienced, objective advisors whose charter it is to protect your interests. Once you are prepared and protected you will find that it’s *always* a tenant’s or buyer’s market. ■

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