By Stephen A. Cross, CCIM

Rules of Thumb When Buying Commercial Real Estate

If you have leased commercial space for at least 5 years you may be suffering from OLD thinking. O-L-D is an acronym that stands for **O**bsessive **L**easing **D**isorder, a term I coined to describe a condition many business people have – *leasing space when they should own the building that houses their business*.

As a rule of thumb, once your business, or medical or dental practice, has established itself as a viable going-concern, and providing you can *clearly* anticipate your space requirements over the next 3 to 5 years, you should consider owning.

This article sets forth several additional rules of thumb related to performing due diligence and making fully-informed real estate decisions.

"Due diligence" is the process a reasonable and prudent person uses to acquire knowledge of facts that, if known, would materially influence his or her decision to purchase property. Things you should 'do' before commencing formal negotiations include: researching the marketplace for suitable properties, obtaining recent "comps", securing your financing, and selecting your team of advisors.

Researching for Properties

At a minimum, you'll want to obtain addresses and parcel numbers of all suitable properties, the sizes of the buildings and land, asking prices, the number of days each property has been on the market, full contact information for each listing agent or owner and insight as to whether any of the parcels have unpaid property taxes. *Rule of Thumb:* The status of property taxes is an indicator of whether the parcel is, or may become, distressed, which could trigger a foreclosure action or short sale. Owners that are delinquent may be in financial trouble and willing to sell at a deep discount to avoid a foreclosure.

Obtaining "Comps"

A "comp" (short for "comparable") is the price a property sold for and the date the sale was recorded. This information is part of the public domain and can be accessed through a city database, where you can also find the amount and status of the property taxes. Of note is that title companies can also provide this information, generally at no cost. *Rule of Thumb*: If you use a title company to get "smart" let them handle the escrow, too.

Securing Your Financing

It's wise to shop for money and obtain a Letter of Loan Approval <u>before</u> you start looking for property. Doing so will confirm how much you can borrow and may influence whether a purchase offer is accepted, especially when competing offers are in the mix. *Rule of Thumb:* Lenders have different underwriting standards and fees. Therefore, contact several and get all loan commitments in writing.

Selecting Your Team of Advisors

Your acquisition team should be dedicated to protecting your interests and include an experienced real estate advisor, real estate attorney, commercial lender, accountant and, in some instances, an architect and contractor. Of note is that the real estate advisor should oversee the time-intensive due diligence process, including conducting the research for *every* suitable building, compiling information on comparable sales, negotiating the purchase terms and conditions, verifying the representations of listing agents and property owners, and interfacing with your other advisors through the close of escrow (which commonly takes 60 to 90 days.) *Rules of Thumb:* Your team members should specialize in their professional disciplines, be independent of each other, have verifiable experience solving your specific problem and be held accountable for their advice and recommendations. Put another way, don't solicit or take legal advice from your real estate advisor or accountant, or accept real estate advice from your accountant, attorney or lender.

Negotiation Rules of Thumb

I suggest that even the most seasoned negotiators refrain from negotiating verbally, either in-person or over the telephone. Why? Because there are many variables to a commercial real estate purchase and in most instances you will be dealing with a listing agent, not the owner. Therefore, reduce all terms and conditions to writing, insist on written responses, and put an acceptance date on all offers and counter offers. Also, in my experience, published asking prices are typically 10% to 20% higher than Sellers expect to receive.

Closing Thoughts

If your business passed the longevity and profitability tests add up the rent you've paid over the years. It's probably in the hundreds of thousands of dollars – and may amount to more than enough to have purchased your own building. My final rule of thumb: If you'd like to start creating wealth for your family, *instead of your landlord's*, you should look into buying.

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