Could This Be The Time To Purchase A Facility?

If you are a small business owner in Denver you might be asking yourself if this is a good time to invest in a property to accommodate your company. Leasing space in the metro area has gotten more expensive over the past 18 months. Overall average office rental rates ended the year with a 2.3% increase over the 3rd quarter, according to the most recent Costar Office Report. While there might be a lot of discussion over how long and high rents will continue to rise or if, in fact, there will be a leveling off; higher rents still remain a fact of life for the Denver tenant in both office and industrial product.

This up tick in rates is attributable, in part, to the perception that Denver is thriving on increased job growth. Investor interest has resulted in building purchases at premium prices as well as developer enthusiasm. Building ownership has turned over at a rapid pace, especially in the office market. New development, specifically in the downtown core area, is more than the city has seen since the 1980's**.**

Every business owner wants to control costs. Leasing space is known to be one of highest fixed expenses along with salaries and benefits. Fixing the cost of using space as well as being able to control maintenance costs along with parking and neighbors is an attractive and exciting prospect for a business.

It may be time to buy when a company can consider the long-term cost, which usually is less than leasing. If a company is facing a lease of 15,000 square feet at $25.00 per square foot for the first year, the annual rent would be $375,000 or $31,250 per month. During each year of the lease, the rent would probably increase by a negotiated increment. Thus over the term of a 5 year lease, assuming that the rent increases by $.50 each year, the cost of tenancy could be approximately $1,950,000. If a building is found which meets the needs of the company and is purchased for $1,950,000 with a 20% down payment, the monthly payment based on an 8% interest rate would be approximately $11,447.00 per month.

The numbers mentioned would, of course, be adjusted for all the variables which inevitably come into play during any real estate transaction. These variables depend on a required down payment, loan terms and, more than likely, needed renovations.

While the money paid in rent is deductible as a business expense and a lease can cut the near-term tax bill, the money used to purchase a facility is not deductible. However, depreciation deductions on the building are available as are the deductions for interest paid on a mortgage. Additionally, depending on such factors as profitability and how much of the purchase relates to land vs. building, buying rather than leasing may save money from taxes. Most important is the role this asset will play if the business is sold or if the business needs to relocate due to expansion or downsizing.

If a company can stay in the same location for a longer hold period and the facility is in an area of appreciating value it may well be the time to start looking.

Once that decision is made the process can begin. Finding a representative broker who knows the market is a key to locating the property and frees up the time the business person needs to spend on the process. Once the parameters and requirements are identified for the broker, finding the property can take some time. To begin looking a year or 18 months before lease expiration is prudent if not necessary. As in most cities across the country finding small properties and/or buildings at the right price in the Denver metro area is difficult but certainly not impossible.

While this process is proceeding, there is now an additional factor to take into consideration which may impact the purchase of that property. The market has a new following the subprime lending woes. Unaffected initially from the fallout of the residential lending crisis, the commercial real estate market is now feeling the effect of tightening capital. However, this is more evident in the new developments and especially residential and land projects where these capital sources have tightened their requirements.

The impact of this may be an opportunity for the small business owner who wants to purchase that property. No longer distracted by that top tier of loan requests, a lending source may very well look more favorably on structuring a transaction for a smaller loan. And there may be an increased desire to deal with small good credit businesses. In other words, while there has been a tightening of capital on the institutional side there may now be more money available for the owner occupant. Additionally the prime rate is going down a bit. Also, for the small business owner, there is available capital through the Small Business Administration. Additionally an owner occupied property might also warrant more favorable terms through a community or regional bank. It might be helpful to use a mortgage broker who can create a submission package which is then delivered to a larger market and usually guarantees acceptance.

Whatever the final outcome on the lending conditions, if a company's cash flow can handle the debt service, usually reflected in a lease rate, it may well be time to consider the options of owning and taking advantage of the current credit crisis.

Paulette Wray is principal of Wray & Associates, a Denver-based Buyer/ Tenant representation firm. Reach her at pwray@wrayassociates.net.