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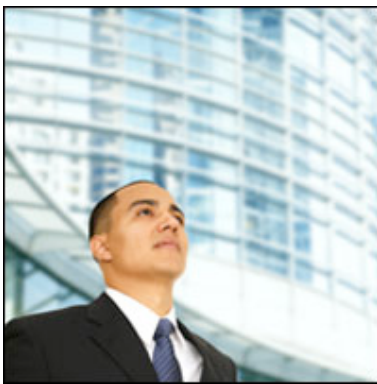
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Should you buy the space you rent?

Commercial real estate prices remain at historic lows, as do interest rates. Is this the right time to buy your commercial property? Only after you weigh all the pros and cons of ownership. Plus: Learn how the SBA has made financing easier for small-business owners.



Most business owners know that opportunity can knock during the most difficult economic times. One sector in which that may be particularly true today is commercial real estate, where low property prices are presenting many small-business owners with some interesting possibilities. The Massachusetts Institute of Technology's Center for Real Estate has found that U.S. commercial real estate prices have dropped an average of almost 30% from a year ago. Interest rates also remain at all-time lows. Could this be the right time to stop leasing and buy commercial

property for your business?

"The answer is 'maybe,'" says Kathleen A. Thomas, Sr. Vice President, Pennsylvania Business Banking Market, Bank of America. "Sure, the commercial property market is appealing today. But a buyer's primary concern should be whether owning and occupying a fixed location fits the company's long-term plan." As is the case with home buying, the expense and commitment of purchasing a business residence is better justified if you plan to spend at least five years at the location. And even at today's prices, buying commercial property requires considerable liquidity.

That's why you need to take a good look at your company's entire financial picture before you make the leap to own. Ask yourself: Is this the best use of my capital today? Does having a permanent location support my business vision for the next five to 10 years? What are the opportunity costs—the potential return of investing this capital in real estate versus the return you could achieve in the stock markets or through expansion? "You have to weigh all these issues carefully," says Thomas. "It gives you a much clearer understanding of the pros and cons of owning commercial real estate."

The upside of ownership

One important advantage of being

SBA recovery funds: A potential boon to property purchasing

The Small Business Administration's 504 loan program has undergone some important changes that small-business owners should take into account when considering financing options for a commercial property.

The American Recovery and Reinvestment Act of 2009 has increased funding for loan guarantees and eliminated fees that could have tacked on as much



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your own landlord: the cost of ownership is fixed. If you lease your space, the owner takes a portion of your rent as pure profit—and you're likely to pay more each year. In contrast, as a property owner, you can effectively charge yourself a fixed rental cost, based on the combination of the monthly mortgage on the property and the amount you need to cover your monthly expenses, such as insurance, maintenance costs and property taxes. "If your mortgage on the property is fixed, to a large degree you can charge yourself a fixed rent," Thomas points out. "We're commonly seeing rates on commercial loans fixed for five years."

The costs of owning may also prove worthwhile if your business has specific or unique space requirements. When you own, you can configure the space to suit your company's needs without approvals from a landlord who may be worried about the property's future marketability. What's more, expensive alterations might not make sense for you as a renter if you can't know for sure how long you'll occupy the premises.

Many would-be purchasers also factor in the potential appreciation of the property over time, and the potential for rental income if there's additional space available on the premises for more than one business. But "a lender won't consider either of these points when approving the loan—and neither should the business owner," Thomas says. "A rise in value or a flow of extra income is icing on the cake, but should not be an essential part of the buying decision." According to Standard & Poor's/GRA Commercial Real Estate Indices, national commercial real estate prices have increased an average 2% annually above the rate of inflation during the past 20 years. But as recent history shows, appreciation is hardly a given. And if you do choose to rent out part of the space, the same tough business conditions that softened commercial real estate prices may leave your tenant struggling to make ends meet—and falling behind on rent.

"A bank's decision on whether or not to offer a business financing is typically based on what the business can afford," reminds Michael Serafino, a Market Credit Officer for Pennsylvania and Delaware for Bank

as 3% of the loan value to the transaction. "In particular, the elimination of those fees has made 504 loans much more competitive," says Kathleen A. Thomas, Sr. Vice President, Pennsylvania Business Banking Market, Bank of America.

This program was already an attractive financing option because it allows businesses to put down as little as 10% of the purchase price on qualifying commercial or industrial property. That helps preserve cash for running the business.

For the 2009 fiscal year, the program's budget includes \$730 million of additional ARRA-authorized funding. Small-business owners can tap these funds for the long-term fixed-rate financing of purchases, improvements and construction of commercial or industrial real estate.

Here's how it works: The SBA, represented by a nonprofit certified development company, provides 40% of the total projected financing. A participating financial lender adds 50% of the cost, and the small-business owner pays the remaining 10% down payment—although some firms choose (or are required by a loan's conditions) to make a larger down payment.

Even if the down payment is larger than 10%, attractive terms still make 504 loans worth considering. These loans are often fixed and fully amortized over a period that can be as long as 20 years—compared with most commercial loans' 10-year period. Locking in debt service for such a long period helps businesses plan better for costs and pay off the loan more slowly, freeing up more capital for other uses.

Some restrictions apply, but generally the program is open to profitable small businesses with a net worth less than \$8.5 million

of America, who says most financial institutions require that more than half of the commercial property be owner occupied. "Relying on rental income from other tenants is risky. A buyer shouldn't purchase more property than the business can cover with its monthly cash flow."

Adding up the limitations

The downside to owning starts with the hefty price tag. In general, expect to spend a lot more up front to buy a property than you would to lease it. A \$3 million purchase, for instance, is likely to require approximately \$700,000 for the 20% down payment and closing costs such as legal fees, title insurance, appraisal and, if needed, an environmental research study. As a way of isolating risk and keeping transactions clear, you may decide to form a limited liability company to hold the property, which costs additional money. Compare that with a renter's initial layout, which often consists simply of a check for the first and last month's rent and sometimes a security deposit.

of not worth less than \$5.0 million and an average annual net income less than \$3 million. "We present both conventional and SBA options to buyers," says Thomas, who also urges buyers to explore county and state resources such as a local redevelopment authority for additional government funding.

Property ownership also comes with inherent costs—both real and intangible. Being responsible for everything from insurance payments to snow removal can distract a business owner from day-to-day management of the primary company. "Sometimes, owning real estate becomes its own secondary business," cautions Thomas. Hiring a property manager is an option, but you have to factor that expense into your decision.

Owning your company's site can also make your business much less flexible. If you need to change your location, it's not as simple as ending a lease—and the outlook for reselling commercial real estate in the next few years is uncertain. But, says Thomas, having a fixed, long-term address for your business can be a real advantage. "Many businesses benefit from having a longstanding position in and relationship to a community," she notes. "When you know that being perceived as such a fixture is right for your firm, it's time to start shopping for space."

If you determine that ownership is the best move for you, this buyer's market is likely to proffer several properties that suit your needs. Deciding which one to purchase calls on the same process you've used to assess whether buying is right: thoroughly examining what will help strengthen the company you've built. After all, says Thomas, "At the end of the day, it's always about choosing the opportunity that works best for your business."

Opinions presented are subject to change based on market conditions.

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As you consider purchasing real estate for your business, consider asking your Financial Advisor these questions:

- How can we model the impact of choosing to buy property versus other opportunities for our capital?
- What factors beyond the down payment should I consider when buying commercial real estate?
- How should I compute the average monthly costs of ownership?
- Which local, state and federal agencies can assist in financing the purchase?

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