

Factors to consider before buying property

All business owners, at some point, have considered purchasing commercial property for their businesses. There are many obvious and not-so-obvious considerations that purchasers need to be mindful of in the decision-making process. Business owners would be prudent to use professional guidance in the various facets of securing their business locations.



**NORMAN
GELFAND**

The following are some risks and rewards to consider:

Working capital. The most important facet in considering purchasing commercial property is how it affects the owner's working capital. The initial investment of the purchase can impede the business' working capital, restrict expansion opportunities and affect the business' ability to operate during an economic downturn.

Functional obsolescence. Over time, business processes change and demands fluctuate. A building may become functionally obsolete if operations change due to advances in technology or other factors. Likewise, if the workforce size increases, space configuration requirements may change, necessitating significant investment in a building's reconfiguration. Therefore, it is important to consider a building's construction and its flexibility when it comes to remodeling.

Economic obsolescence. Does the building have enough size and amenities to reflect the company's image? Does the age of the building affect the ability to produce revenue in concert with the company's projected growth?

Demographic obsolescence. Factors that affect the desirability of the location can change the value of the investment. Deteriorating neighborhoods can raise employees' concerns about safety and security and require unforeseen costs of protective services and, ultimately, lower the market value of the investment. Changes in nearby roadways and public transportation may make it more difficult to attract desirable employees. If the business owner plans to sell the company in the future, demographic obsolescence can create a significant decrease in the value of the business.

Appreciation of value. Short-term economic fluctuations aside, historically, buildings in the Austin area have appreciated at an average of 3.5 percent per annum. Also, keep in mind that a portion of the mortgage payment is debt service, and the owner's equity in the building increases as mortgage payments are made on the property.

Tax advantages. The depreciation expense connected with the value of the building is a reduction of ordinary income, up to 40 percent, assuming the owner is in a 40 percent tax bracket. At the time of sale or disposition, the owner is taxed on the recapture of the depreciation as a long-term capital gain of 15 percent. In actuality, taxes are not paid on the difference between the depreciation and the long-term capital gain, which, in this case, would be 25 percent — a significant savings for the owner.

Hedge against inflation. Building ownership secures a guaranteed cost for occupying the location of choice. As building replacement costs for a like kind and quality increase, rental rates increase as leases renew. However, these increases are circumvented if the business owner also owns the location. Furthermore, as the replacement costs increase, so does the value of the build-

ing.

Control of property. Along with the pride of ownership, a business owner who owns a location is able to control the unique value of the property — for example, signage, expansion opportunities, level of maintenance and improvements. Additionally, the owner determines the building's rules, such as hours of access, air conditioning usage and types of businesses that may occupy a portion of the building.

To ensure a smooth experience, prospective buyers should put together an acquisition team. Buyers will need a certified public accountant to analyze the viability of the purchase, a source to secure financing options, a real estate broker to locate properties, and a real estate attorney to draft the offer and evaluate and approve closing and loan documents.

Also, it is imperative to have a structural engineer and specialty contractors conduct inspections of the building's structural, mechanical and exterior systems. An architect should be enlisted if remodeling is necessary.

Professional guidance in purchasing a commercial facility can make the difference between a rewarding experience and financial turmoil.

NORMAN GELFAND is president of Austin commercial real estate firm Gelfand Group. He can be reached at (norman@gelfandgroup.com).