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When Should You Buy a Building?

By Bob McGee

When should your business consider buying a building? There are a number of variables that enter into the decision.

First, you need to view the purchase of a building for your business as a long-term investment and plan accordingly. The current sub-prime residential disaster was caused, in material part, by people buying houses as a short-term investment and thinking the value was always going to increase. You need to look at a business building like investing in the stock market - you are in it for the long-term because over the long-term you should realize a good profit from the building. If you are looking to flip the building in a year or two, don't make the decision to purchase one.

Next, carefully decide if you can afford to own your own building, not if you can find someone to loan you the money. If you can afford it, you are halfway to getting a loan. A good rule of thumb is if your current rent expense will cover the loan payments and other costs of owning a building. Many business owners overlook the costs related to owning a building - things such as property taxes, full insurance on the building rather than tenant insurance, repairs and maintenance, etc. As a tenant, the landlord has to fix the air conditioner when it breaks. As an owner, it is your cost and responsibility.

Decide on a size of building, type of building and location that will benefit your business. You need to own a building large enough to handle your growth for the next four or five years. Location is always critical. This includes zoning and legal restrictions.

Next, ask yourself if you want to buy an existing building (perhaps with some remodeling) or if you want to construct a totally new building? Both of these options carry their own benefits and risks. New construction is rarely on time or on budget. Existing buildings may have hidden problems or issues (think "This Old House"). If you construct your own building, you will have to find an architect, an engineer, a general contractor and a bank that is willing to make a construction loan. A bank is at a very high risk during a construction or remodel. A number of banks are willing to make the permanent loan, but refuse to make a construction loan or will require additional equity/collateral during the construction phase.

Also, be careful not to fall in love with a building or your plans for one. You are buying a long-term, working asset to benefit your business and your financial future. This needs to be a sensible and practical decision, not one based upon your dreams. Likewise, don't buy or construct or remodel special features that will have limited appeal to your future buyer. You might really want solid mahogany doors, but will a buyer in the future want them enough to pay for them? They also won't appraise at their cost, so you will have to put additional cash into the building.

You could also consider having unrelated, third party tenants in your building. In many cases, this can reduce your cash flow needs for the new building, but carries its own set of risks. Evicting a non-paying or problem tenant can be a lengthy and expensive process. Additionally, you may not want the clients that might do business with your tenants. You need to consider if your tenants will create a poor atmosphere for your business (think about a restaurant sharing a building with a funeral home and a veterinary clinic). The headaches of tenants may not be worth the advantage of additional cash flow.

Be prepared to think about, and budget for, all of the other costs of leaving your rented space and owning a building. The cost of moving can be expensive for some businesses who need to dismantle and reassemble large pieces of equipment. You may also need to buy new furniture and furnishings to go with that new building.

Once you've thought through all of the above, you need to contact a reliable real estate agent to start finding the building or the land (if you're constructing a new building). Based upon what the real estate agent says your to-be-located building should cost, you should talk to your banker to discuss all of the decision points above and how you have addressed them. Have your current and historical financial statements, for both you and your business, with you and ask the banker if they will prequalify you for a loan to buy your building when you find it. Strongly consider talking to several banks to get different viewpoints, pricing and loan structures. SF

Bob McGee, a fourth generation banker, is president of Southwestern Business Financing Corporation (SBFC, www.swbfc.com), the most active 504 lender in Arizona. SBFC, which originated in Phoenix in 1981, is one of less than 30 SBA Premier lenders in the country.