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THE BAUER REPORT



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Condominiums For Business Owners

Like apartment dwellers who are finding that it is less expensive to buy than to rent, business and professional firms are moving toward buying offices rather than leasing. While buying or constructing an entire building is an option for major corporations or for smaller firms outside metropolitan areas, owning commercial space generally means being part of a condominium structure.

The strongest demand for small office buildings is from lawyers, doctors, advertising firms and other professional and service companies, as well as small private corporations. These firms often accumulate capital not needed in their business, and their occupancy of a particular location can have value to them in the form of goodwill so that they are interested in controlling the space.

Financial Point Of View

From a financial point of view, the basic appeal of commercial condos space is that over the long run, owning can be considerably less expensive than leasing. While rents may be low in the current market, renewals over the years are likely to mean rent increases. By comparison,

mortgage financing is now available at relatively low fixed interest rates for terms of ten years or more. In addition, well-located and well-maintained space can appreciate significantly over the period of ownership.

Tax considerations are less favorable for owners as compared to tenants. A tenant can deduct 100 percent of rent payments as a business expense. A condominium owner can deduct only the interest on a mortgage loan, as well as depreciation (using a 39-year life). While the tax benefit of leasing may be slightly better than those from owning, the likelihood of appreciation of value should more than offset the difference.

Advantage of Condo Ownership

A further advantage of condo ownership is that it eliminates undesirable provisions that may be in a lease. For example, a landlord may have the right to relocate the tenant if a major tenant requires more space. In general, small tenants have little negotiating power when negotiating a commercial lease.

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This publication is not a solicitation but is an information service from this office.

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When ideas in tax and other legal areas in this publication seem to fit your situation, it is recommended that you discuss them with your professional advisor before taking action.

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Management Concerns

Like a residential property, a commercial condominium is managed by a board of directors made up of unit owners. Certain matters may require approval of a majority of owners, thus assuring each owner a say in any decisions affecting the building. Often the condominium charter gives the board a right of first refusal when a unit is offered for sale. In this way, control over the type of building occupants can be maintained. This arrangement frequently prevails when all occupants of the building are in the same or a related business or profession.

A frequent concern of small business or professional owners is that space requirements may change at some time in the future. In a rental building, where turnover is likely to exceed that in a condominium, a tenant is more likely to be able to adjust its space requirements. In the case of a condominium, an owner anticipating a future need for more space can buy a larger space initially and lease it short-term until required (assuming leasing is permitted). However, it may be more difficult to obtain additional space if needed. □

Consider Who Might Be The Buyer When You Want To Sell

If you are new to investing in income property, you may have made a choice in advance of the type of investment property that you wish to own. There are many good types of investment properties: apartments, office buildings, shopping centers, high rise parking garages in downtown areas, warehouses, resort rentals and many others.

Each of these takes a different type of management. Any and all should be under professional management during your ownership. Good management will ensure a profit for you when the investment is sold.

Even before buying the commercial property, you should consider who might be willing to buy it when you want to sell. The specific buyer doesn't need to be identified, but the type of purchaser should be. Will it be an individual, a syndication, an institution, or a pension fund?

Think about it! If you cannot think of potential buyers now, why is the property being purchased?

By identifying the type of potential future buyer, an investor in a property can better concentrate on what features such a buyer will most likely want. Then the investor is able to operate the property with the management company in such a way as to enhance the attractive features, thereby maximizing the property's value to the most likely type of buyer. Here are a few examples of resale factors for particular properties.

- **Apartment buildings** are usually purchased by pension funds and insurance companies only when they are Grade A properties. Syndicators look

for Grade B or higher properties. Wealthy individuals are the most likely prospects for apartment buildings that need to be upgraded and modernized.

- **Office buildings** are typically purchased by users (a bank, an insurance company, or a corporation that intends to occupy all or a major part of the building for its own operations). Foreign investors increasingly seek fully tenanted, income-producing office buildings for long-term investment.
- **Resort properties** (time-share units, and campgrounds) generally have a weak resale market. Sale by auction is a distinct possibility and that often results in bottom-dollar prices.

Other Resale Considerations

In addition to identifying potential purchasers, an investor must determine carefully the appropriate time to sell, the economic outlook, potential tax considerations of a sale of investment property, and other uses for the money that a sale would bring. And an investor-owner should make every effort prior to offering the property for sale to ensure that the financial and physical condition of the property justify the maximum possible price. In a shopping center, for example, the rental income stream, cash flow, and occupancy level should each be at the highest possible level. When they are, a greater number of potential buyers will emerge.

Like-kind exchanges are often a tax-wise alternative to resale of investment property. Savvy investors keep alert to exchange possibilities as part of their focus on resalability of a property. □

The Appropriate Management Plan

Real estate investments can be set up to generate one or more types of returns:

- Cash flow to owners (yield or return on investment).
- Appreciation of owner's capital (capital appreciation).
- Shelter of cash flow and/or other income from taxation (tax benefits).
- Preservation of capital (safety).

Once the owner specifies the type(s) of return desired, the mix of returns, and expected timing, the property manager can develop an appropriate management plan. Planning, with its resulting control, is the foundation of effective

property management.

If, for example, the owner wants to maximize cash flow for a two-year period, the property manager would probably plan to defer as much maintenance and repair as possible. Considering the short time period, the manager can reasonably assess that deferring certain maintenance and repair would have only a limited effect on the property's resale value. If, instead, the property were expected to be held over a long term, the property manager would probably design a strong preventive maintenance program and give corrective maintenance high priority, thus preventing significant deterioration of the investment over time. □

Space Sharing Executive Suites

With the revolution in communications, building owners must keep up with the changing needs of the corporate tenant. Often the larger, well-organized businesses do not need the space that was necessary just a few years ago. Electronic communications to and from employees have substituted for leased office space. Managers are more willing to grant favorable lease terms to operators of shared space. The operator sometimes receives a monthly management fee for operating the shared space plus a portion of rent revenues over a certain amount.

Tenants in an office suite are offered a private office within the suite that has a receptionist, secretarial help, conference rooms and other amenities. This can be a big saving for small space users or users who need a small office for only a short period of time.

Another user is from the large corporation that needs small

branch offices in different parts of the country. Other users might be individuals who need a private space for investment or other work activities as well as professionals such as attorneys or accountants who work primarily away from their offices.

Existing Leases

Companies that have excess space that cannot be leased in its entirety can use the concept of shared space. The company's existing facilities such as copier rooms, computer rooms, cafes already are available. Any income from this type of shared space can be nearly 100% profit.

If this is space that is leased by the company rather than owned space, the lease must be reviewed carefully to see if a sublease could violate the sublease/assignment clause of the lease. □

Quick Profits When A New Hospital Is Built

What happens to nearby property values when a new hospital is built? Usually the surrounding area feels a ripple effect. Land values increase. Developers are quick to provide new space for offices and stores. The biggest profits are realized by the investors who get involved early (during the planning stages) before or while the hospital is built.

In one location in the Southeast, as a new hospital went up, the area around it began to pop its economic seams. Among the new activities that created an abnormal demand on land located near the hospital were:

- Physicians offices.
- Walk-in clinics.
- Medical supply companies.

- Residential apartments for hospital employees.
- Fast food outlets.
- Day Care centers.

A few decades ago when doctors regularly made house calls, hospitals were isolated structures and viewed as "places to rest". Now, however, doctors prefer to locate their offices near the hospital. The whole area begins to boom with ancillary services that are both directly and indirectly related to health.

There is often a need to expand the medical facilities at existing hospitals to handle a growing population and larger numbers of senior citizens. Land prices can soar when the hospital decides to buy nearby land for expansion. Watch for it, the alert investor can again have an opportunity for profits. □

Are These Items In Your Leases

The following is a useful list of items that should be clarified between the parties in the lease of a commercial building:

1. What is the amount of usable space? Since the rent may be based on a square foot rate, the rate may be quoted on a rentable or a usable area. Rentable space means the actual office area, plus a proportionate share of facilities and corridors that service the floor on which the office is located. This concept is used in most buildings. Usable space is the actual space located within the walls of the office and excludes any part of the service facilities.
2. Who pays the broker's commission? Maybe the broker has been working for the tenant, but the fee is usually paid by the lessor. Often the lessor has hired the broker to represent him in the negotiation. The lease should reflect the obligation and who will pay it.

3. On what basis is electric current or other utilities paid? The tenant usually will pay for his own utilities. However, it can be computed in two different ways. It could be a flat rate added to the rent. Sometimes, each office is provided with its own meter and charged only for the actual consumption of the utilities.
4. What services will be provided? There are a number of services in a building. There may be elevator service, air conditioning, restroom maintenance, parking that is available to tenants or will be rented. The tenant's right to use these services and the limitations should be spelled out.
5. Is there a "most-favored tenant" clause? If a tenant moves into a new building that is only partially filled, he may demand a clause in the lease that will give him the benefits of any rental concessions that the landlord may subsequently make in order to obtain tenants. □

Help With Investment Real Estate

When you have searched for new real estate investment opportunities, with values that have been changing, you know that finding and evaluating them is becoming more sophisticated and complex. More investors are turning to real estate consultants as a means of providing a sounding board for their ideas as well as expertise in the planning and construction stages for their projects.

Today's investor in real estate must have a grasp of market conditions and potential that is usually beyond their own available time to attain. Investors need assurance about the true condition of the market. With increased competition, the market place is becoming more complicated.

Feasibility studies are essential for commercial office, industrial, resort and hotel investors. With this kind of

information, planning is better and there is less chance for error.

Real estate investing is not just looking for the structure and the land. It is investing in the type of property that you want at the price and terms that suit you at the time you want to make the purchase.

Our office is open and ready to assist you. We have been experts in property values in this area for a long time. We can help you with enough information so that you can make your own decisions on the value of property either in listing your present property for sale or in purchase of another. If you wish to consider structuring a tax-deferred exchange into that next property, we can guide and aid you with that transaction.

Let us guide you in your investments. □



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A CCIM is a professional real estate practitioner with proven technical expertise in commercial property. A CCIM is a person truly committed to the fundamentals of effective commercial-investment brokerage. The CCIM has completed a full schedule of Post Graduate Level Courses in investments, taxation, development and marketing all types of commercial-investment properties. The designation of Certified Commercial-Investment Member is unquestionably the highest degree awarded in the commercial-investment real estate practice.

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