Buying a building may be attractive alternative to leasing space

by Mike Boyd, CRE, SIOR of Boyd Commercial
Houston Business Journal, August 21, 2006

It's no surprise to tenants of industrial buildings who have renegotiated their leases since the first of the year, that rents are going up.

The trend of decreasing vacancy rates, which started over 24 months ago, has led to a tightening of the market to the point where landlords can increase rental rates. Increases in construction, land and financing costs have also played a role in boosting the level of rents landlords need to receive on projects built since 2004.

A ready-made alternative to leasing for companies that lease less than 20,000 square feet is the purchase of a newly constructed freestanding building. With the ample availability of still relatively low interest rate loans, companies that buy a facility instead of leasing space may find that their debt service payments are less than their rent has been.

There are new developments of freestanding buildings for sale or lease in many parts of the city. Primarily located near the Sam Houston Parkway in the southwest, west and northwest areas of Houston, these buildings typically range from 10,000 to 25,000 square feet in size and may be constructed of metal, masonry or tilt-wall concrete.

Features can include being "crane ready." The facilities may have both dock and grade truck loading capability and may also have either a finished out office or an office allowance built into the price.

Depending on the size and level of improvements, purchase prices can range from the mid-$50s to over $65 per square foot. Buildings that have substantial office finish will cost even more.

It may make sense for those companies with a lease coming up in less than a year to look at the alternative of purchasing a building rather than renewing. Owners and managers of companies with a lease expiring in 18 months or longer, may want to consider having a building built to their specifications.

There are several areas to consider before taking the plunge:

- Down payment. Typically, a prospective building owner is required to put 20 percent to 30 percent of the purchase price into the building as a down payment to get a fixed rate, long-term conventional loan. If the borrower qualifies for a SBA loan, this amount could be reduced, but the other terms of the loan may not be as attractive. The question for the individual borrower is: Does it make sense to invest this money in a piece of real estate where the returns are typically around 10 percent a year versus investing it in the company's business operations?

- Future growth. Will the building that company owners are considering purchasing give the business a home for the mid- to long term? Before buying, company owners and managers should try to project the company's space needs over the next 10 years and feel comfortable that the facility they are purchasing will accommodate those needs.

Many of the new buildings available from developers today have limited expansion capability. If a company is experiencing dynamic growth, its best bet may be to continue leasing to maintain the flexibility to move at the end of the lease term rather than be saddled with a long-term commitment.

- Investment potential. Is this the best place to invest the company's money? If the company doesn't need the money that would be used for the down payment for its business, and if it can reasonably be projected that the facility will accommodate the company for the foreseeable future, and if the total cost of occupancy (debt service, taxes, insurance and maintenance) isn't much greater than the projected rental payments, "do it."

Over the long term, owning a facility will help a company fix its occupancy costs and yield a fair return on its investment.

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