Steve Bergsman is a freelance writer in Arizona and author of several books. His latest book, "After the Fall: Opportunities and Strategies for Real Estate Investing in the Coming Decade," has been ranked as a top-selling real estate investment book for the Amazon Kindle e-reader.

To Buy or Not to Buy

That is the Question...

By Steve Bergsman

With the value of office and industrial buildings declining by 30 percent, 40 percent sometimes 50 percent in certain areas, should tenants consider buying instead of leasing? The answer is: maybe.

There are no quick and easy answers because of numerous ancillary influences, including the health of local companies, the direction the regional economy is heading, and how active the financial institutions are in that particular sector of the country.

"I'm not sure everyone could get money," says **John Skoglin**, **SIOR,** a vice president with CB Richard Ellis Group Inc. in Baltimore. "Financing is not available to everyone. The lending institutions want you to be able to back up a loan with collateral other than the building. It could be a reach for some smaller companies."

Add to the mix the personal biases of certain brokers and even captains of industry.

"I personally favor leasing over buying," asserts **Greg Gunn**, **SIOR,** a senior vice president of Coldwell Banker Real Estate Corp. in Salt Lake City.

While some brokers like Gunn suggest leasing is still a better option, others recommend outright purchases to their clients. Again, however, the availability of financing is a key issue.

Appreciation of Capital

"One of the impediments to a recovering economy is that banks are slow to loan money," Gunn observes.

This assertion is backed up by **Andrew Jaffe, SIOR,** vice president of sales and leasing at Commercial Properties Inc. in Tempe, Arizona. "You continue to hear bankers preach that they're willing to give money, but the underwriters and everyone above of them are scrutinizing every line item on every return that is provided. The banking industry is so strangled, they can't figure out who is on first base."

That maybe the case in economically hard-hit Arizona, but elsewhere things are better, at least according to **John Barker, SIOR,** senior vice president of development in the Charlotte, North Carolina, office of Red Rock Developments, who comments, "I would say money is more prevalent west of Mississippi. If you are in California or Texas, you are seeing more forgiving situations for borrowing money than you are in the East."

If one peels away sections of the Southeast from the rest of the eastern seaboard, the banks seemingly are backing away from their stingy programs of the last four years.

"We have found in the last three or four months, those banks that have not lent any money in the last two or three years are now advertising in the newspapers," notes **George McCutchen, SIOR, CCIM,** an industrial broker with Grubb & Ellis/Wilson Kibler in Columbia, South Carolina. "I had a banker call me recently saying he wanted to do deals, wanted to lend money on the right projects. Banks and companies that [had] put everything on hold are starting to look around."

Scott Hensley, SIOR, CCIM, a partner with Piedmont Properties/CORFAC International in Charlotte, North Carolina, would agree. "One regional lender recently sent me an e-mail with his rates, a 15-year amortization, 85 percent loan-to-value with three-year fixed money at 3.8 percent," Hensley says. "He would even do a five-year at 4.2 percent. That's as close to free money as you are going to get."

Contributing SIORS

John Skoglin, SIOR

Greg Gunn, SIOR

Andrew Jaffe, SIOR

John Barker, SIOR

Hensley cautions, "This is not investment stuff, which is more 60 percent-40 percent loan-to-value. This is more for smaller, end-user companies. And there are enough of them around with confidence to make a deal."

Let's Make a Deal

In the last four to five months of 2010, the Charlotte market saw a sharp increase in sales activity, says Hensley. This was surprising because over the prior 24 to 30 months, there had been almost no sales transactions in the metro's industrial market.

Before the recession, Hensley was doing 75 percent purchases and 25 percent lease deals, but in 2010 it all reversed to 25 percent purchases and 75 percent lease deals. Not great, but still better than 0 percent purchases.

What's driving the comeback in Charlotte is pricing. Smart buyers are picking up good properties at relatively low prices. In one recent deal completed by Hensley's office, a company toured a 120,000-square-foot industrial building and closed two weeks later in an all-cash transaction at $15 a square foot, says Hensley. "The seller looked at the numbers and said, 'This is nowhere near where I thought it would be, but it solves a problem for me. OK, I'll do it.'"

In another Hensley deal, a New York textile company had been eyeing the Charlotte market for a number of years before deciding to scoop up another 120,000-square-foot property.

"The buyers are actually going through bank financing and the Small Business Administration although they had the ability to write a check for the whole thing," Hensley says. This had been a $20 to $25 a square foot property, but the buyer got it for closer to $16 a square foot."

When McCutchen reviewed 2010, he assumed most of the deals at his company were leases, but when he brought the subject up at a year-end meeting, it turned out his office in Columbia, South Carolina, ran about 50-50 between leasing and sales.

One deal he worked on was a 28,000-square-foot warehouse sitting on two acres of land. "The buyer didn't quite need all the space, but he liked the location," McCutchen says.

The deal got completed because the buyer had a creative solution: He got one of his own clients to take part of the space as a tenant.

"I tell my clients this is absolutely the best time to be buying because most everything is on sale at a steep discount," says McCutchen. "Values have come down 30 percent to 40 percent in this market from their highs. Leasing has plenty of advantages, but you don't build any equity; you don't see those dollars again. Maybe not 2011, but around 2013 or 2015, things are going to pick up and buyers will be getting a couple of percentages on their investments."

"Will there be more sales in 2011 than 2010? Yes. Will there be a glut of sales? No."

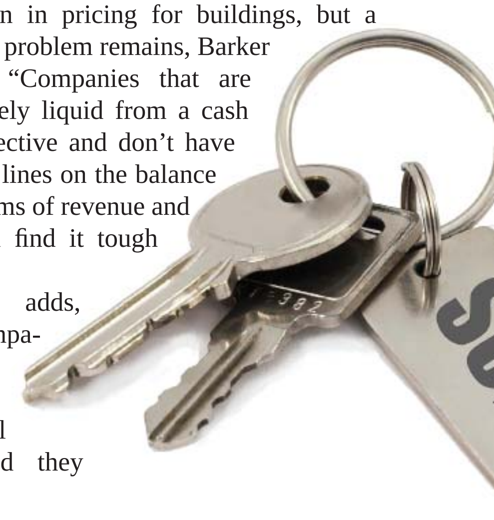
If you only need about 2,000 square feet, it may not be an advantage to buy, suggests Skoglin. "On the other hand, if you need 50,000 square feet or more, it would be a good time to buy. If it were up to me and I could get the money, I would buy, because we are at a low ebb and real estate is a cyclical business. People made a lot of money because the properties they bought from 1991 to 1994 turned into big dollars a decade later. Businesses bought cheap then, and it was money well invested because it kept overhead down."

John Steinbauer, SIOR, president of Steinbauer Associates Inc., Miami, Florida, also recommends buying although his home market has been very unpredictable for industrial properties. The Miami market hasn't loosened up because owners are still holding on by their fingernails and the banks haven't been having fire sales, Steinbauer observes. As a result, valuations have come down only about 20 percent as compared to leasing, where rates dropped 35 percent.

If a potential buyer likes the lower-priced lease rates but still would like to buy something, Steinbauer suggests a lease-with-option. "If I'm representing the buyer/tenant, I would attempt to get them to lease with some sort of option to buy/first refusal depending on the length of the lease. If the seller is really firm on price, won't back off and you really want the property, lease but have a safeguard about purchasing some time in the future."

The Many Advantages of Not Being an Owner

"A lot of small companies still want to be purchasers, and it makes sense to buy because of the huge compression in pricing for buildings, but a huge credit problem remains, Barker maintains. "Companies that are not extremely liquid from a cash flow perspective and don't have good trend lines on the balance sheet in terms of revenue and profits will find it tough to borrow."



Barker adds, "The companies that I dealt with in 2010 all leased, and they

did so predominantly because of the credit challenges. Three years ago, you could have borrowed 90 percent of the money. Today, in an owner-occupied, user-occupied deal, you could get no more leverage than 70 percent. It's tough for many companies to do a deal at that."

Gregory Schenk, SIOR, president and founder of The Schenk Company Inc. in Columbus, Ohio, says his company does about 30 deals a year, and over the past four years only one of the clients bought instead of leased. Historically, about 40 percent of The Schenk Company business involved sales transactions.

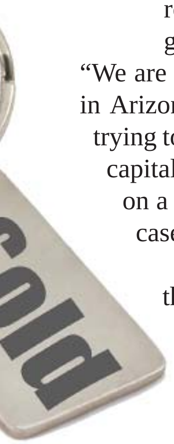
The decline in sales is due partly because of the credit issue and partly because companies don't want to part with cash.

"We'll do a lease-versus-buy analysis," says Schenk, "but a majority of my clients don't even want to consider buying. They are trying to hoard all the cash they have. They're cutting back on space, not hiring new people, and trying to get the best bang for their buck in real estate."

When considering lease versus buy, Gunn in Salt Lake City says the choice is usually to lease because of a number of overriding factors:

- *Flexibility*. The beauty of a lease is that you only have to commit for as little as one, three, or five years. When you purchase a building, you own it until you no longer own it.
- *What you need*. With a lease, you get the exact amount of square footage you need. When you buy, you often have too much space or too little.
- *Choice*. For every one building for sale, there are 40 for lease.
- *Location*. There are many more locations where you can lease as compared to buy.
- *Capital*. Working capital is a precious commodity and companies can get a better return investing in business operations as opposed to real estate.
- *Dynamism*. Business by nature is dynamic; real estate is a static, fixed asset. Businesses get too big or too small for their space.

"We are definitely seeing more leases," notes Jaffe in Arizona, "the reason being, small business are trying to keep their heads above water by retaining capital. They are not so apt to put money down on a building with no mechanism to pull out in case things go sideways."



Historically, in the Tempe marketplace, the bulk of sales were for mid-range buildings of 5,000 to 25,000 square feet, and that arena has suffered substantially, Jaffe adds. "Companies are preserving cash reserves and doing so by taking advantage of aggressive rental rates. Guys are saying, 'We are at a pretty good rental rate, so why should we make a move?'"

A Year of Change

Whether an advocate of leasing or buying, most commercial real estate brokers are predicting sales will come back in 2011—with provisos.

"There will be more people taking advantage of cheap prices, but only if the banks begin to loosen restrictions and become more aggressive," says Jaffe. "Will there be more sales in 2011 than 2010? Yes. Will there be a glut of sales? No."

The window for buying will stay open until the economy starts to demonstrate signs of improvement, McCutchen adds. "At that point you will see the best of what is out there be acquired. The top 10 percent will be bought. Then lending rates will rise and properties won't be as attractive as right now."

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