

Benefits of Building or Converting The Commercial Condo Building

By Craig A. Lane, CCIM

The condominium form of ownership for an office or other commercial building has one great advantage to the builder or developer: It makes it possible for him to recoup his capital immediately and, in addition, obtain a substantial profit. However, he does have to take the time, trouble, and expense of selling the condominium units and fulfilling registration requirements in many states.

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The builder may also furnish management services after the condominium units are sold. Some builders retain ownership of some commercial space in an office building and in this way retain a continuing income from a cigar stand, luncheonette, or other small business.

The Benefits to the Developer-Investor:

The builder or developer of a condominium office building and his investors benefit in the following ways:

- 1. Fast Return of Capital:** The investor or developer gets a quick return of capital as each condominium unit is sold.
- 2. High Profits:** In a well-planned project, profits should be at a high level. In a condominium office building, for example, a pretax return of 20% of gross sales should be feasible. Further, by holding on to certain profitable areas of the project, the investor-developer can get a continuing return on the project. Looking to the condominium once more, the investor-developer can hold on to the pharmacy, luncheonette, other store areas and parking and other commercial space.
- 3. Low Risk:** The advantages offered by the condominium to its prospective unit buyers should make for relatively easy sales and low risk, assuming the sales program is carefully worked out and aggressively pursued.
- 4. Benefits of Ownership:** To the extent the investor-developer retains ownership of space, he benefits from the same advantages his purchasers get.

How Condominium Unit Purchasers Benefit:

The investor-developer can offer his prospective unit purchasers the following advantages:

- 1. Dollar Savings:** The major selling point that the condominium unit purchasers will make over the period of their occupancy as compared to renting.
- 2. Income tax Benefits:** The condominium unit purchaser pays no rent and therefore does not get any rent deductions. But he does get business deductions for the payments he makes. These deductible payments include interest on the mortgage given to financing the purchase of his unit, real estate taxes, and maintenance and repair charges, as well as depreciation deductions. The depreciation deduction is based on the full cost of the condominium unit although it was purchased with a small cash down payment.
- 3. Improvements:** The buyer retains ownership of the improvements he adds to his unit. When he sells, the price he gets should reflect those improvements.
- 4. Occupancy Tax Benefits:** Commercial occupancy taxes on tenants imposed by some cities do not apply to condominium unit owners.
- 5. Equity Position:** A condominium unit owner owns the fee title to his unit plus a percentage interest in the common areas and facilities. He therefore has capital gain potential and protection against inflation. He is also secure against rent increases and the threat of non-renewal of his lease.
- 6. Freedom of Action:** Each condominium unit owner is on his own as to financing, taxes, insurance, decorating, and designing. Each is free to sell his unit when it suits him to do so.

7. Maintenance Benefits: Each unit owner is not directly responsible for maintenance as he would be in an individually owned building. He does have a voice in how the building maintained and operated, and he gets help from the other unit owners.

8. Appreciation f Value: The chances are very good that the unit will increase in value as soon as all the units are sold or rented and the building is in full operation.

9. Common Areas and Facilities: The common areas and facilities (e.g., parking areas, railroad sidings, etc.) give the small firm owner of a condominium unit advantages it could not otherwise afford.

10. Flexibility: A condominium unit owner can sell his unit at any time. A tenant must, of course, wait out his lease term. However, a condominium unit owner must expect that, at any given time, there may be no ready market for his unit. While a condominium unit owner can lease or sell part of his condominium unit when he no longer needs the entire unit, a tenant can't sublet without the landlord's consent.

The Condoback

If a property owner uses a unit in his building and leases the rest of the property, he can convert the building to a condo and retain his unit. A variation of on the sale-leaseback approach, this technique, known as the condoback, gives owners of office buildings and other business property a great deal of flexibility in financing their properties.

This is how it works: Let's say an attorney has an office in a building he owns. The rest of the building is rented to other professionals. To raise cash, the owner wants to sell the property. He also wishes to continue his legal practice in the building.

The owner sells the building to one of the tenants or some other party who is willing to convert the building to office condominiums. The buyer, in turn, sells the previous owner's office back to him as a condominium unit. The seller might wish to buy more than just that unit, so that he can either rent out another unit or retain for expansion.

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