

BUSINESS INSIGHTS

FIVE REASONS YOU SHOULD STOP RENTING AND BUY YOUR NEXT FACILITY

Business owners are enjoying the benefits of owning their own real estate.



Occupancy costs comprise a major line item for any business. And while location is important, the stability and long-term fit of your real estate is also critical.

Trying to plan ahead for growth and future requirements, while preserving cash flow and affordability, can be a lot to balance.

It doesn't have to be this way. More and more business owners are enjoying the benefits of owning their own real estate. Established, profitable companies can buy instead of lease. What follows is an overview of why you may want to become your own landlord and a few things to help you determine if you are a good candidate for ownership.

1. Availability of High-Leverage, Long-Term, Stable Financing

While interest rates are up from their all-time lows of 2022, they remain in a historically normal range. Government-guaranteed programs such as the SBA 7(a) loans and SBA 504 loans provide 20- and 25-year fully amortizing commercial loans that look and feel much more like a traditional residential real estate loan. The long-term structure of these loans minimizes monthly payments, preserving cash for other business needs. In some cases, these loans can provide 90% and even 100% financing for the real estate and project costs, and the mortgage payment can be the same or lower than paying rent.

The costs of equipment and construction and/or buildout can usually be rolled into the primary loan, replacing more costly specialty equipment financing. The result is more cash flow freed up for the business, which can now be used for marketing, hiring or expansion.

In many situations, the seller of the property will provide what's called a seller note, which can be counted toward the equity

injection of the borrower. This structure can help further reduce the initial out-of-pocket costs of buying property.

2. Control Your Destiny and Enjoy Flexibility to Maximize Use of Space

When you own your property, you can build and/or configure your facility just as you want it. As you anticipate future growth, you can purchase more space than you need today and sublease that space to other businesses that have synergy with your own; for instance, if you own a pet boarding facility, sublease to a pet grooming business or veterinary practice. This will provide you with additional income to pay for the facility today and provide room to expand when you need it. It might even bring in more business!

Owning your building gives you the security of knowing that you're not going to be subject to a lease termination, rent escalation, property sale, poor maintenance or other whims of a landlord. Since your mortgage is stable, you can budget more accurately and better control expenses year over year. It's one less thing to worry about.

3. Tax Benefits of Ownership Can Make It More Attractive Than Renting

The ability to deduct interest expenses, taxes and depreciation of property and equipment can provide significant reductions in the taxes paid by your business at the end of the year.

These savings are not available to renters. In cases where the monthly costs of ownership are higher initially, there is often a recapture at tax time that can be equal to — or even larger than — the total cost of renting. Be sure to check with your tax advisor for specific aspects of your situation and state and local tax laws.

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4. Build Asset Value and Income Stream for Retirement by Investing in Yourself

When you pay rent to a landlord, you are essentially paying “infinite” interest, since you don’t benefit from ownership in any way! When you own, you are paying rent to yourself. Over the years, you will build up equity in the property as you pay down your loan. You will also benefit from any appreciation of your building. When it comes time to retire, you might sell your business but retain the real estate and collect rent from the new owner. In this way, owning real estate provides independent business owners with an attractive retirement vehicle.

5. Refinance Other Debt as Part of the Acquisition of Real Estate

Most businesses that qualify for buying instead of renting have been operating for some time and have likely accumulated various loans as they have grown and become established. An added benefit of acquiring real estate comes from the opportunity to refinance loans that are typically at higher interest rates, and on shorter amortization schedules, into the long-term loan used to buy the real estate. By doing this, a business can consolidate debt, lower monthly payments and simplify accounting.

Preparing for a Real Estate Purchase.

Before beginning a property, search and approaching a bank about getting a loan, you should do some homework and get prepared. This includes making a realistic assessment of your suitability to buy real estate.

Buying a building is not a strategy for every business.

Companies move through different stages, and a young, new venture experiencing rapid growth may not have the available cash to cover the cost of ownership. Banks want to see stable and growing revenues when they make loans. Until your business can demonstrate the ability to handle the costs of a loan (opens new window) and real estate ownership, it doesn’t make sense to buy.

Prepare early for buying property. Make sure your finances are in order. Pay your bills and your taxes timely. Your personal credit score and your company’s record with vendors will also be considered in your loan application. Work with your CPA to prepare end-of-year statements that show your business can repay debt and that you as the owner/manager have the ability to run your business and manage it successfully. Your company’s ownership structure and succession plan should be clean, logical and well-documented.

Have a financial plan of what you intend to do when you buy the property and prepare a 12- to 24-month financial budget to show that you understand what you are getting into and how it is going to help your business grow and thrive.

Develop a team to help you explore the real estate market and different lending programs. A real estate agent and a banker

will be critical in advising you on what you can afford, where to look and how to structure your search — and ultimately, your offer and loan package.

Certain areas of the country are experiencing rapid real estate appreciation. That’s great if you bought property five years ago but may be more challenging if you are in the market now. **Work your plan, have patience and wait for the right opportunity to come along.**

Every business is different, every real estate market is different, and state and local zoning and tax laws are different. Make sure you understand the implications of each of these as you look at the benefits and suitability of owning instead of renting your facility. With the right approach, you will find the benefits of ownership to be significant.

This is not a commitment to lend. All offers of credit are subject to credit approval and not all clients will qualify. Fees may apply. See your Relationship Manager for details.

About the Author



George Harrop

Managing Director,
National Small Business
Lending
Phone: 301-272-3710

George Harrop is the managing director of Banc of California Small Business Lending. The small business lending team at Banc of California has originated over \$6 billion of small business loans. Lending capabilities include: 1) loans ranging in size from \$500K to \$8 million; 2) SBA 7(a), 504 and conventional loans anywhere in the U.S.; 3) higher loan to value than traditional loan products; and 4) lending to dozens of industries, including franchises, physicians, veterinarians, pet boarding and grooming facilities, professional offices, insurance agencies and many more. We are a designated SBA Preferred Lender.

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