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Buying Commercial Real Estate

A Guide for Entrepreneurs

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Buying commercial real estate: A critical decision

Buying commercial real estate is one of the most important decisions you'll ever make as an entrepreneur, and potentially one of the most profitable, too.

Ownership of your place of business not only gives you greater freedom to shape and control your business operations but lets you build equity as well.

However, without proper planning, advice and preparation, buying a commercial property also comes with major risks that can wreak havoc on your business if left unchecked.

Learn everything you need to know to navigate this challenging business transaction. From budgeting, to negotiating, to avoiding potential pitfalls, this eBook will lead you through the steps required to ensure that one of the biggest transactions your business ever undertakes is a successful one.

1

Getting started

- Is buying commercial real estate right for you?
- Assessing your needs
- Building the right team

Before you start shopping for your business property, make sure you're laying down the right foundation by following a number of important initial steps.

Take the time to carefully consider your current and future business needs, and build the right team of advisors by gaining a good understanding of the key roles they play in the process.

To start, make sure that buying commercial real estate is the right move for your company by carefully weighing the risks and benefits involved.

Is buying commercial real estate right for you?

How can you be sure that buying your place of business is the right move for you company? Here are some key considerations.

Purchasing commercial real estate will often make sense if some of the following statements are true.

- **Location is important**
  If you found a location that helps you grow sales through foot traffic and ease of transportation, reduce costs through proximity to key suppliers or attract and retain employees, you may want to purchase it.
- **You want to build your personal wealth**
  Commercial real estate has been a great investment for many entrepreneurs in recent years. Ownership can build wealth and equity apart from the profits of your operating company.
- **Your current lease or leasehold improvements are getting costly**
  It often makes sense to buy a property if you're investing heavily in the leasing costs.
- **You want to be free of landlord woes**
  If running every aspect of your business without potential limitations, restrictions and rent increases is important, then buying might be right for you.
- **You need to free up working capital**
  A well-financed property purchase can free up working capital by reducing your monthly outlay for rent. The difference can be used to build your business.

Not every business is ready to buy a commercial building. If you decide to buy commercial real estate, pay close attention to the following.

Cash flow and stability
Buying a building is a long-term investment. Before you buy, make sure your company will have the resources to support this commitment in the future.

Rising interest rates
Low interest rates have encouraged many entrepreneurs to buy in recent years, and many commercial properties have enjoyed considerable market appreciation. However, rising interest rates could result in rising costs that your business might not be able to absorb.

Cost overruns
Many entrepreneurs are surprised how much it costs to move their operations to a new location. Expenses may include costs for movers, furnishings, renovations, new machinery and equipment, and building design and construction.

Business disruption
Productivity and sales often drop before, during and after a move. Many entrepreneurs don't realize how much of their attention a move is going to demand.

Go deeper
Complete this free real estate assessment to find out if you are ready to puchase commercial real estate.

Assessing your needs

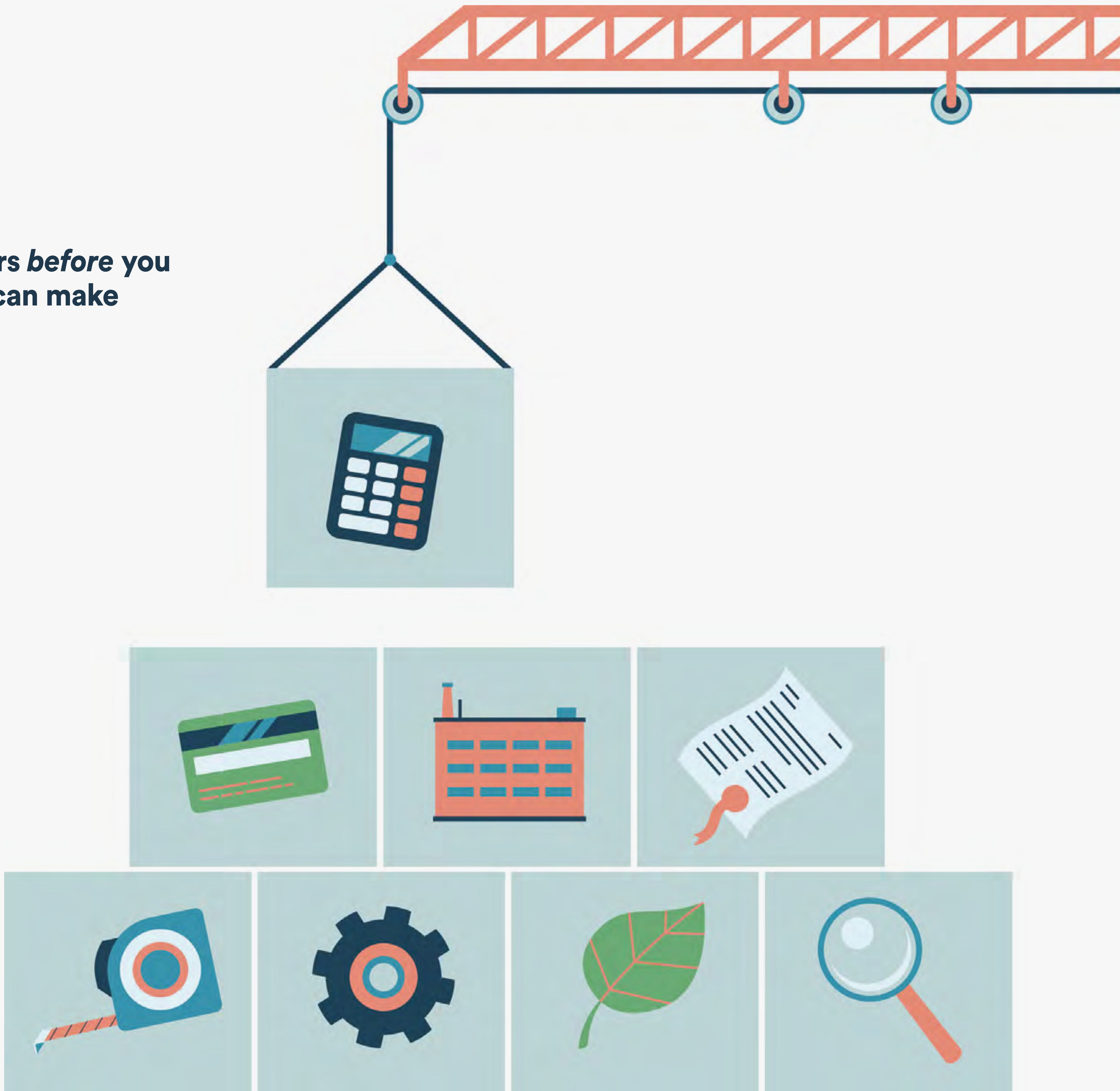
A commercial real estate purchase is a complex and costly undertaking, so you want to make sure your new property will meet your company's needs for years to come.

With this in mind, here are some of the main areas to consider when shopping for commercial property.

- **Location**
  It's essential to find a location that allows you to serve your customers and be accessible to your employees.
- **Space**
  How much space are you going to need as your company grows?
- **Configuration**
  What kind of configuration will best support your business needs? It might help to speak to an operational efficiency expert.
- **Parking**
  Make sure you have enough parking spaces for customers and other visitors, as well as your employees.
- **Power, water, and heating and air conditioning**
  Your business may need more electricity, water, or heating and air conditioning than is currently available in a building you're considering.
- **Machinery and equipment**
  A move is an excellent time to add or upgrade machinery and equipment.
- **Financing**
  A banker can ballpark how much financing you can get to buy a property and how much you could borrow for related expenses. Knowing this will save you time when shopping for your property.

Free eBook:
Create a Leaner, More Profitable Business: A Guide for Entrepreneurs

Building the right team

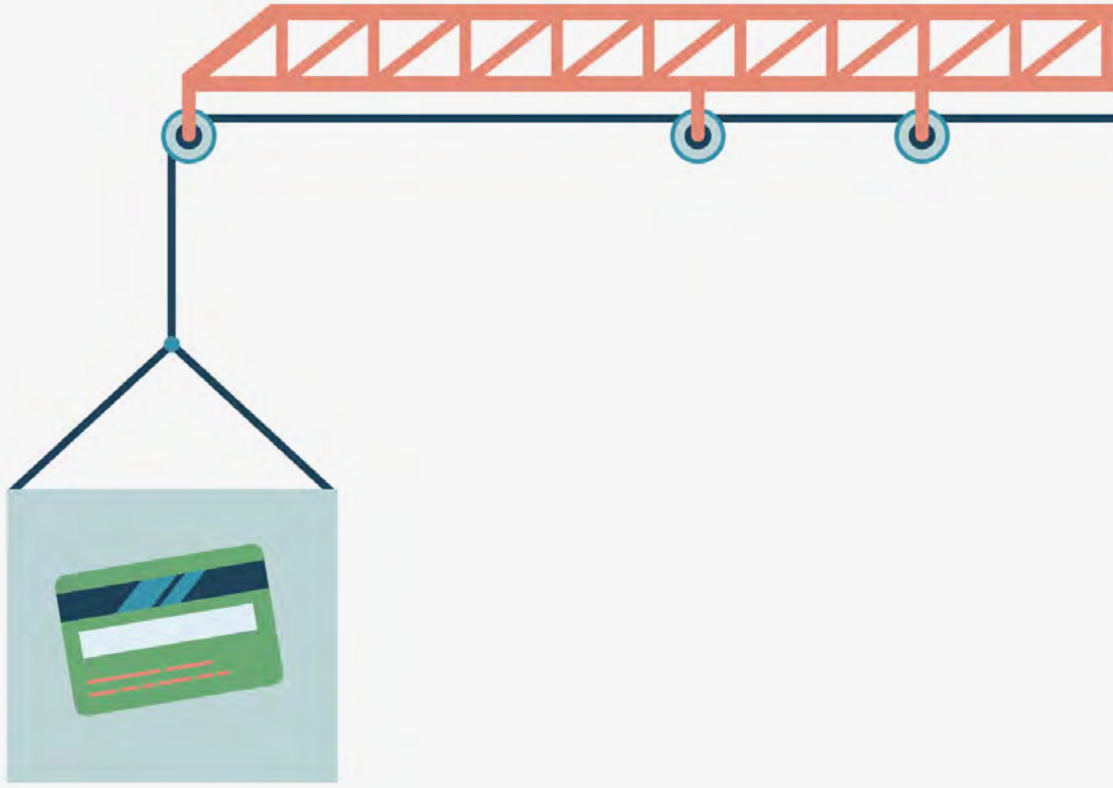


Putting together the right team of advisors *before* you start shopping for a new business space can make all the difference.

Here are eight advisors you'll need:

1. an accountant
2. a banker
3. a commercial realtor
4. a lawyer or a notary in Quebec
5. a contractor
6. an operational efficiency expert
7. an environmental consultant
8. a building condition inspector

Building the right team of advisors: What you need to know



1

An accountant can

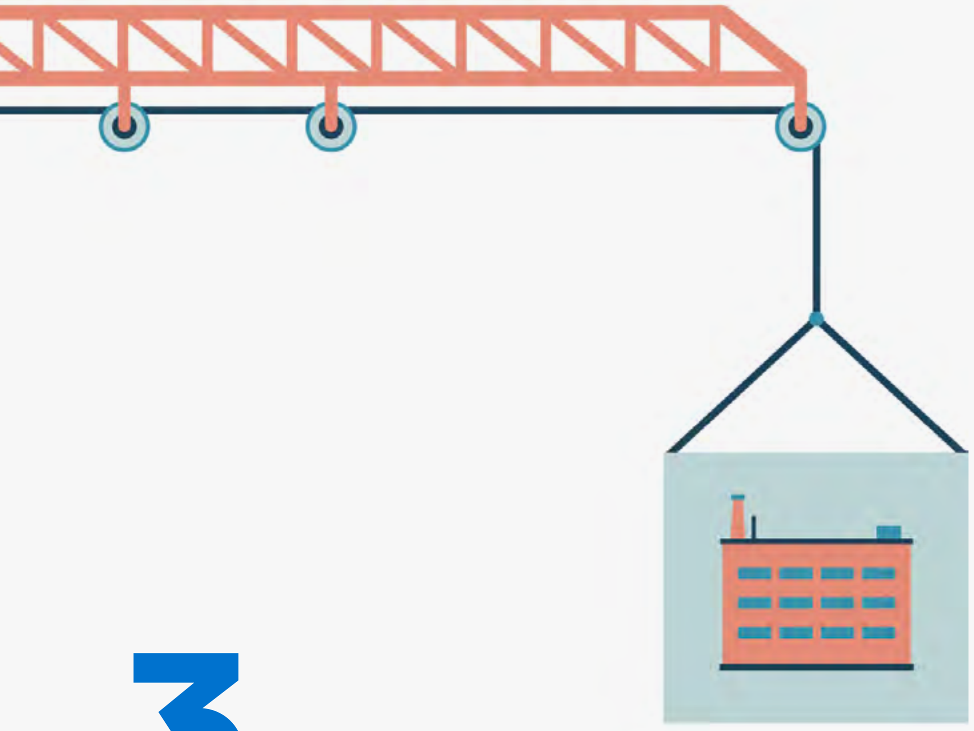
- look at your company's financial performance and strategic plan
- help you decide whether purchasing real estate is the right decision at this time
- help you ensure you've made a realistic budget and have up-to-date financial statements to take to the bank
- advise you on how to optimize the transaction for tax purposes

2

A banker can

- help you understand how much money you can afford to invest to avoid taking on too much debt or putting pressure on your monthly cash flow
- give you a second opinion on your budget to make sure you've planned for all the expenses you're likely to incur

Some banks offer more favourable loan terms than others, so it's a good policy to shop around when looking to finance your real estate purchase.



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A commercial realtor can

- help you find a property that meets your needs, within your budget
- advise you on negotiating the transaction with the vendor
- shepherd you—with your lawyer or your notary in Quebec—through the offer to purchase and closing stages of the transaction
- inform you about your local market—including, possibly, available properties that are not listed for sale

4

A lawyer or a notary in Quebec can

- review your offer to purchase to make sure it includes all the necessary conditions (this is especially important when the property is held in a corporation)
- help you negotiate with the seller
- review the sale contract once you've struck an agreement, and perform other aspects of your due diligence
- advise you on the tax and other personal finance implications of owning real estate

5

A contractor can

- be essential if you're constructing a building or substantially renovating an existing one
- help you finish your project on time and on budget

6

An operational efficiency expert can

- give you an opinion on whether a prospective property is suitable for your needs
- advise you on how to lay out your operations to minimize waste and maximize value, once you've purchased your property

7

An environmental consultant can

- determine whether a previous occupant has contaminated the property
- assess the environmental condition of the property and stand by those conclusions
- carry liability insurance in case of error

8

A building condition inspector can

- alert you to issues with the building that will require substantial investments to correct

2

Shopping for your commercial property

- 5 key questions to ask yourself
- 6 potential pitfalls—and how to avoid them
- 8 hidden costs: Budgeting effectively

The commercial building you choose will have a big impact on your business. Ideally, its size, layout and location should enhance your operations while respecting zoning and environmental regulations.

Commercial buildings come in a wide variety of shapes, locations and prices, so you have to know what your needs are and how much you can afford to pay.

An independent commercial real estate advisor can help you set criteria for choosing the right building. This advisor should know the area and be familiar with zoning regulations and any potential issues concerning the building, its location or its potential uses.

5 key questions to ask yourself

1

Is the location well adapted to my needs?

- Retailers and professionals need a property that can easily be found by existing and new customers. Manufacturers, on the other hand, should think about easy access to highways and other modes of transportation.
- Think about how far your employees will need to travel to reach the new location. A building in a central, easily accessible location can give you a strategic advantage.

2

Does it require modification?

- If you've found a suitable building in a good location, consider what it will take to make it just right.
- Use an accredited inspection company to evaluate the building for defects and the entire property for environmental contamination. Defects can be points for negotiation with the seller—or signs of future headaches best avoided altogether.

3

What are the local taxes and infrastructure?

- Taxes vary among municipalities, with some towns offering preferential rates in the hopes of attracting businesses.
- Your commercial realtor should know what the taxes will be, as well as the infrastructure and utilities that are available at the sites you're considering.

4

Does it allow for future growth?

- It's great to have room to expand. However, paying for extra space that may come in handy in the future might not be the best use of your working capital.
- Before investing in extra space, you should be reasonably sure you'll need it within a relatively short period.

5

Am I separating my needs from my wants?

- It's easy to become overwhelmed. Once you've looked around and seen what's available, make a "must-have" list of the things your business truly needs. Then make a wish list of features it would be nice to have.
- Buildings that lack all the must-have criteria should be struck off your list, so keep the must-have list short: If it's too long, no building will ever qualify.

6 potential pitfalls— and how to avoid them

Make sure you're paying special attention to these areas when considering a commercial property.

1. **Advisors**
   Your best defence against costly errors is to plan your purchase carefully and find experienced advisors.
2. **Zoning**
   Ensure the property is zoned appropriately for your business's needs. Commercial and industrial zoning restrictions can be stringent, so it's important to know what is and isn't permitted. Also, zoning bylaws change over time. Just because the previous occupant used a property for a specific purpose does not mean you will be permitted to do the same.
3. **Heritage buildings**
   Heritage classifications often limit the alterations you can make to a building and increase their costs.
4. **Building permit**
   If you plan to build on a property, you will need to apply for a building permit and comply with applicable bylaws. Check with your municipality to see what you're allowed to do with and without a permit.
5. **Certificate of survey**
   Make sure you have an up-to-date certificate of survey. If you purchase a property without one you might be in for an unpleasant surprise when it comes to upgrading the building.
6. **Due diligence**
   Get a building condition inspection and an environmental site assessment before buying. Get a lawyer or a notary in Quebec to perform thorough due diligence on such issues as land title, zoning, outstanding taxes, liens, easements and other potential problems.

8 hidden costs: Budgeting effectively

1. **Purchase costs**
   Purchase costs include more than the price of the property. For example, you may have to spend a significant sum on due diligence, such as environmental and structural assessments, an appraisal, and a title search.
2. **Closing costs**
   These may include land transfer tax, legal fees, a realtor commission and sales tax. If you have an existing mortgage, you may also face a prepayment penalty.
3. **Contingencies**
   You should set aside an extra amount—about 10% to 15% of the purchase price—for unexpected contingencies.
4. **Renovations and repairs**
   Renovations and repairs may be needed to make the site suitable for your business. Big-ticket items can include the roof, windows, foundation, siding, plumbing, electricity, heating, ventilation and air conditioning.
5. **Moving costs**
   These include the costs of moving furniture, equipment and inventory; setting up phones and Internet service; making signs; marketing your new address; cleaning up any site contamination or hazardous building materials; and repairing your existing location to return it to its original state.

6. **Permits**
   You could also face costs to resolve any permit and zoning issues, encroachments (structures that extend onto a neighbour's property), and easements (a right to use part of a neighbour's property) identified during due diligence.
7. **Downtime**
   Often overlooked is the cost of downtime during the move, so be sure to calculate the cost of any ramped-up production needed to build inventory to ensure uninterrupted supplies to customers.
8. **Operating costs and increases**
   Operating costs generally include financing, utilities, property taxes, insurance and maintenance, such as snow removal, janitorial services, landscaping and property management.

TIP
Ask the current landlord for past bills and research how much operating costs have gone up in recent years.

3

Financing your commercial property

- Understanding your financing options
- How to get financing: 7 tips for success
- 5 ways to maximize the value of your investment
- Case study: Empire Sports

Whether you're moving into, renovating, leasing or buying commercial real estate, it's helpful to understand the variety of financing options that may be available to you. Take the time to explore which ones might be the right fit for your project and to uncover the various options for the support you may need during this often-challenging time.

Understanding your financing options

It's helpful to understand the variety of financing options. Take the time to explore which ones might be the right fit for your commercial real estate project.

- **Commercial real estate mortgage loan**
  This is the main type of financing available for a commercial real estate purchase. The interest rate is important to consider, but other terms can also be critical to the success of the purchase.
- **Working capital loan**
  This type of short-term loan is often amortized over about five years and is generally unsecured. It is meant to help your business pay for investments in its growth. It can also help you cover the costs of buying equipment or hiring sales staff.
- **Equipment loan**
  If you're planning to buy equipment for your new space, an equipment loan may be useful. Such a loan is usually amortized over the life of the equipment—typically, five to 12 years. The equipment acts as security for the loan.
- **Demand loan**
  This type of loan can be useful for paying for a move, buying equipment or covering a temporary cash shortfall, and it has no fixed maturity date. You can renegotiate it as your business situation changes, or you can pay it back in full or in part at any time, without penalty. As well, the lender can require repayment of the loan at any time.
- **Line of credit**
  This is a short-term, flexible loan that you can tap quickly during a sudden cash crunch or to pay for renovations.
- **Vendor financing**
  This type of loan is sometimes offered to a buyer by an eager property owner to help ensure the sale goes through.

How to get financing: 7 tips for success

1

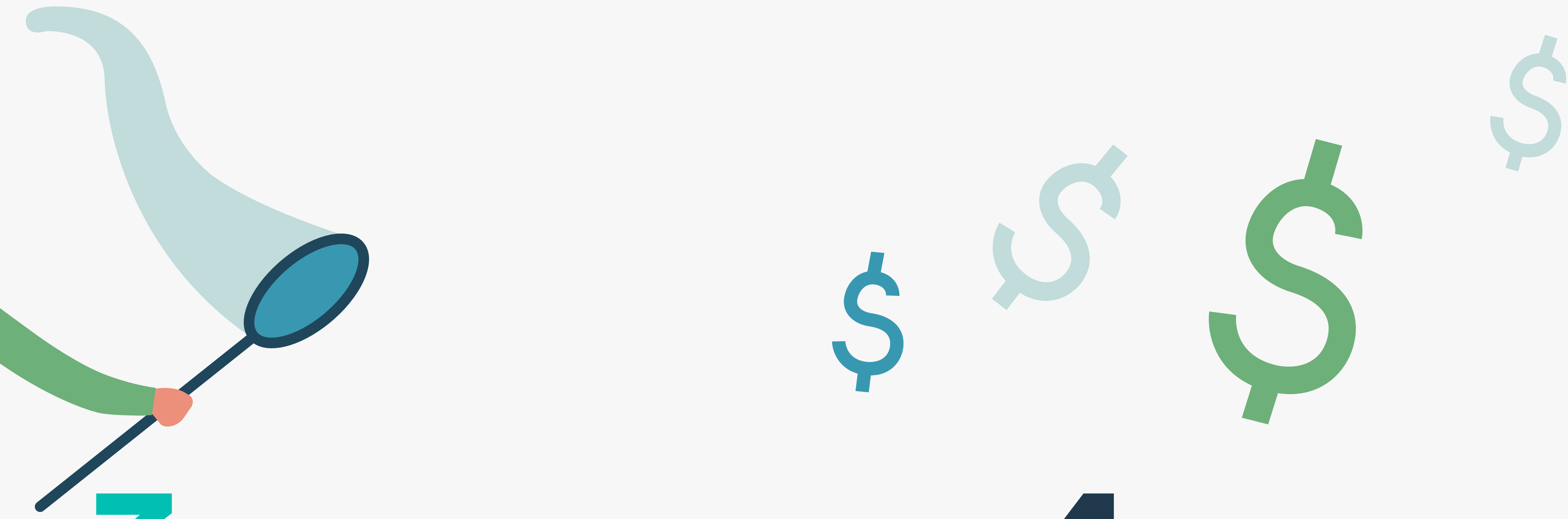
Show profitability

- The most important requirement for getting financing is having a profitable and growing company.
- Start by making sure your company's finances are in order.
- Banks like to see a proven record of profits. A business with no profitability doesn't have good chances of getting financing.

2

Show careful planning

- Thoughtfully assess your real estate needs. Bankers want to see evidence of solid planning.
- Figure out your budget, desired locations and square footage needs, and how you'll accommodate projected growth.
- When budgeting, consider not just the purchase price, but also extra costs associated with the property.



3

Have a property in mind

- Banks decide how much to lend based not only on your finances, but also on the type of building, and its condition, age and resale potential.
- If you don't already have a property in mind, a bank may agree to a preliminary meeting to give you a ballpark idea of how much financing it could provide. Such a meeting is generally advisable only if you already have a good relationship with the banker.

4

Prepare your documents

- Once you have a property in mind, prepare the documents you'll need to show the bank. These include up-to-date financial statements, a solid business plan and details on the property you're interested in.
- Banks also like to see evidence of an experienced management team.

5

Meet the bank before bidding

- It's best to meet your banker before bidding on the property you have in mind, especially if it's your first foray into commercial real estate.
- The bank will also advise you on its conditions for granting financing. Those may include obtaining environmental and building condition assessments, an appraisal, and a title search. Each bank keeps a list of approved experts in due diligence. If you use someone else, you could delay the transaction.

6

Give yourself time

- Your purchase offer should also give the bank enough time to review the transaction. It's common for offers to provide only 30 days, while banks often need six weeks—and possibly more, if due diligence issues arise.
- Businesses often don't give enough time for the bank's due diligence. That can lead to the buyer and vendor arguing about extensions to the offer, and the transaction may even be cancelled.

7

Investigate loan terms, not just rates

When speaking with banks, look not only at their rates, but also their terms, which may be just as important to your bottom line.

- One of the most important variables is the **loan-to-value ratio**—the portion of the property's value that the bank will finance. Banks generally offer to finance 75% to 100% of the value of commercial real estate. Any shortfall must usually come from your company's working capital or your personal funds. A higher loan-to-value ratio means more money remains in your company in the near term to invest in growth or cover cash shortages.
- A second variable is the **amortization period**. This usually ranges from 15 to 25 years for commercial real estate. A longer amortization period means more money stays in your company's hands now.
- A third very important consideration is the bank's **flexibility** in terms of loan repayment. For instance, you may be able to get a holiday on principal payments for one or two years post-transaction to absorb the cost and disruption of the move. In another example, if a cash shortage occurs later, flexible terms could allow you to make interest-only payments for several months.

Note: The bank may also be able to roll some or all of the cost of renovations into the mortgage loan, particularly if they add value to the property.

TIP
Calculate how much your loan might cost your business by using this free business loan calculator.

5 ways to maximize the value of your investment

Commercial real estate is a big investment, so it helps to know which factors can help raise the value of your property—value you can then reinvest in new technology, training and development for employees, or expansion into new markets.

Here are five ways to maximize the value of your investment.

1

Look for multi-use zoning to increase value

It's wise to look at commercial space with multi-use zoning, so that when it comes to selling your premises, you have an edge.

As a rule of thumb, the wider the allowable uses of a building, the higher the market resale value, so make sure you carefully assess zoning restrictions for a commercial space before buying.

2

Buy the amount of commercial space that reflects market demand

Buying too much commercial space is a common temptation for entrepreneurs. However, doing so can affect the future marketability of a property.

Most Canadian businesses are small enterprises, and they're not looking for large spaces to meet their needs. You can assume that the larger the building you buy, the smaller the pool of potential buyers who will be interested in the place when you sell.

3

Place your commercial real estate acquisition into a separate holding company

It's often wise to place your commercial real estate into a holding company separate from the operating business. This can make it easier to sell your business, because many buyers will want to acquire only the operating company.

It also makes it easier for you to hold on to the real estate and use it as a source of retirement income and facilitates the succession of the business.

4

Invest in a LEED-certified building

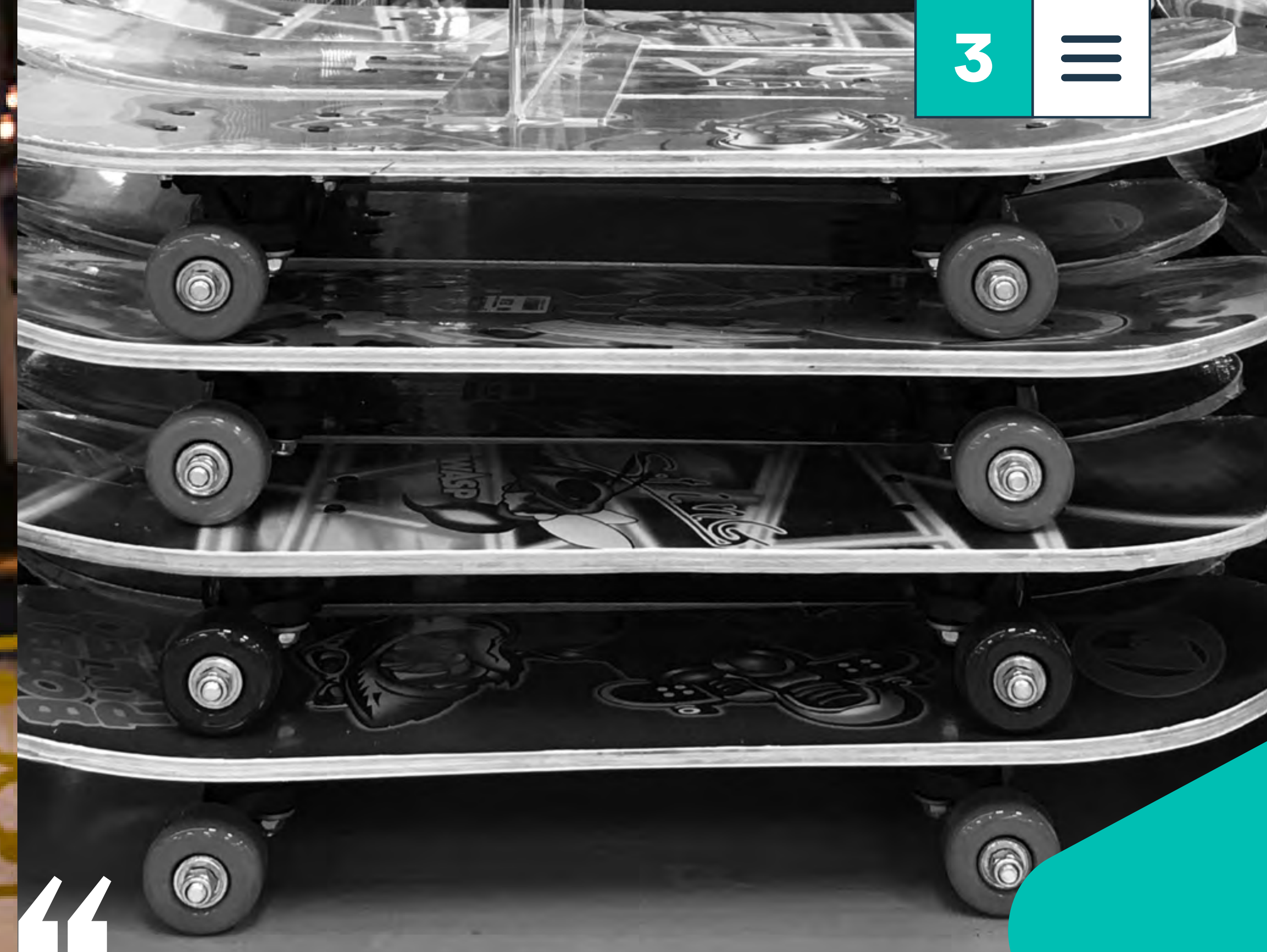
Although entrepreneurs scouting the market for LEED-certified buildings or retrofitted properties will usually pay a higher price, they can recoup those costs due to improved energy efficiency and increased employee productivity related to better air quality and design.

5

Work with an experienced commercial real estate broker

Many entrepreneurs do too much speculation and not enough research when making decisions about the space they need.

A broker will evaluate the space that fits your specific business needs, but will also help ensure you're optimizing every dollar spent. Brokers will assess the commercial real estate market to see what types of properties are in demand and calculate the space you need to accommodate future growth.



Case study
Empire Sports

Like many entrepreneurs, Philippe Grisé and his partners, Patrick Byarelle and Frédéric Pierre-Antoine, were happy leasing their retail space—until the landlord of one of their key locations decided to sell the property.

That's when they faced a big decision: to buy the building or deal with a new landlord.

"If you're wise in business, it's almost a foolproof opportunity."

— Philippe Grisé
Co-owner and co-founder
Empire Sports

Grisé and his partners decided to line up financing and buy the building. Today, they own four properties, including a 3,700-square-metre (40,000 square foot) head office and warehouse on Montreal's South Shore.

As Grisé and his partners gained experience investing in real estate, they also became increasingly comfortable with all the financial responsibility that comes with it.

Founded in 1999, the company now operates 10 stores across Quebec, including an impressive new 1,200-square-metre (13,000 square foot) location in downtown Montreal.

While the company leases several stores from large developers, Grisé and his partners buy the properties where they operate whenever possible, as investments—"sort of our retirement plan," says Grisé. The partners hold the properties in a joint holding company that leases them to Empire, a common approach.

Grisé calls the property holdings a good investment for his personal financial future—the "cherry on the sundæ" of Empire's success.

He recommends that entrepreneurs carefully project their costs with the help of designers, architects and other professionals, including a lawyer or a notary in Quebec who can advise on permits and other regulatory hurdles.

Ultimately, according to Grisé, once you've done your planning and homework, there's no reason to hesitate.

"If you're wise in business, it's almost a foolproof opportunity," he says. "But if there's a problem, you have to attack it."

4

Closing the deal and moving in

- How to negotiate to your best advantage: 7 steps
- Before you close: Your due diligence checklist
- 6 tips for a successful move

Negotiating an effective purchase agreement that takes into account all of your interests—including your employees' concerns, your company's growth and your bottom line—is crucial.

Never sign a purchase agreement before performing due diligence. Be sure to give yourself enough time to do so.

Help ease your company through the transition to a new property by communicating with your employees.

How to negotiate to your best advantage: 7 steps

1

Think about your needs

To negotiate more effectively, begin by thoroughly evaluating your business needs and how the building's current setup might meet them.

2

Set your budget

Setting an effective budget with your accountant and financial partners up front can give you more negotiating power with the vendor because you will be clear on what you can afford.

3

Find good advisors

Find a good commercial realtor who understands your needs and knows the local market, including unlisted properties. A realtor can be critical in your negotiations with vendors.

4

Cast a wide net to save money

To save money on your purchase, consider the following approaches:

- buying a remotely located building, a former special-use property, a repossessed building (via a distress sale) or space in an industrial condo building
- approaching building owners whose properties aren't on the market to see whether they're interested in selling
- buying a building with more space than you need, then leasing the excess space to a tenant

5

Investigate your site thoroughly

Look carefully at any promising properties before making an offer. The better informed you are, the more ammunition you'll have to bargain with the vendor.

6

Make an effective offer

Now that you've done your homework, use your findings to prepare an offer that reflects your budget and needs. This is a good time to:

- obtain a better price and shorter closing period, if you make an offer with fewer conditions
- ask for vendor financing
- propose a deal that allows the owner to sell the building but rent back part of the business space
- build in sufficient time for due diligence and bank financing approval (six weeks or more)

7

Involve your bank before you sign off

Don't sign off on the conditions of the due diligence process until your bank has reviewed the contract and agreed to provide financing. If the bank refuses financing after you sign off, it will be too late to change your mind.

Before you close: Your due diligence checklist

When you've finally found the right building for your business, it's imperative to perform due diligence before making the purchase. This will help minimize risks and ensure the building is a sound investment.

Here's a checklist to help you make sure you're covering all your bases before buying a commercial building.

- Request all of the following documents from the seller:
  - leases with current tenants
  - maintenance contracts
  - insurance policies
  - title documents
- As you examine the documents, build a list of questions and issues to be checked by your acquisition team. Make sure all team members have clear task-completion deadlines. Follow up with them frequently.
- Carefully examine the following elements: the **full physical condition of the building**, all **liens and obligations** associated with the building, the **insurance policies** and the **security of tenant incomes**.
- Go over your business plan, cash flow projections and numbers that dictate what you can afford with your accountant. Try to take into account all growth that could result from planned projects, as well as your future borrowing needs.
- Prepare a brief synopsis of your financing needs, financial planning and assets for presentation to a lender. You will need to assess the following:
  - interest rates;
  - repayment options;
  - the personal guarantees required by your financial institution.

- If possible, try to get a preapproved loan so that you know exactly how big your budget is before you begin your search for a building, and be realistic about those financial forecasts.
- Check that you have met all of your lender's conditions before signing an offer of purchase, such as an **environmental site assessment** or **building inspection**.
- Protect your cash flow during this transition period by obtaining a complete quote for moving expenses and including it in your application for long-term financing.

TIP
Give yourself 30 days to perform due diligence, beginning on the day you receive the final document you've requested from the seller.

6 tips for a successful move

Follow these guidelines for a smooth transition from your current location, with limited disruption to your business.

1

Be proactive

Many businesses wait too long to move. Start thinking about it before tight space starts disrupting operations. If employees are tripping over each other and can't find a quiet meeting place, you've waited too long. At that point, it will be hard to manage a problem-free transition to a new space.

2

Create a timeline

Work with employees to come up with a timeline for the transition. The timeline could include time for doing renovations, moving assets, setting up phones and Internet, buying new furniture or equipment, making signs, and marketing your new address. Also, decide who will be responsible for each task. It can help to put someone in charge of the overall transition.

3

Build up inventory

You may want to build up extra inventory before the move in order to have enough stock on hand to ensure an uninterrupted supply for production needs and clients.

4

Consider a staggered move

Consider maintaining both spaces—the current and new ones—for a short time, and moving machines and inventory on a staggered schedule to minimize impact on workflow.

5

Give yourself extra time

Transitions often take longer than expected. Businesses typically underestimate production downtime during the move, and renovations commonly cost more than budgeted.

6

Communicate

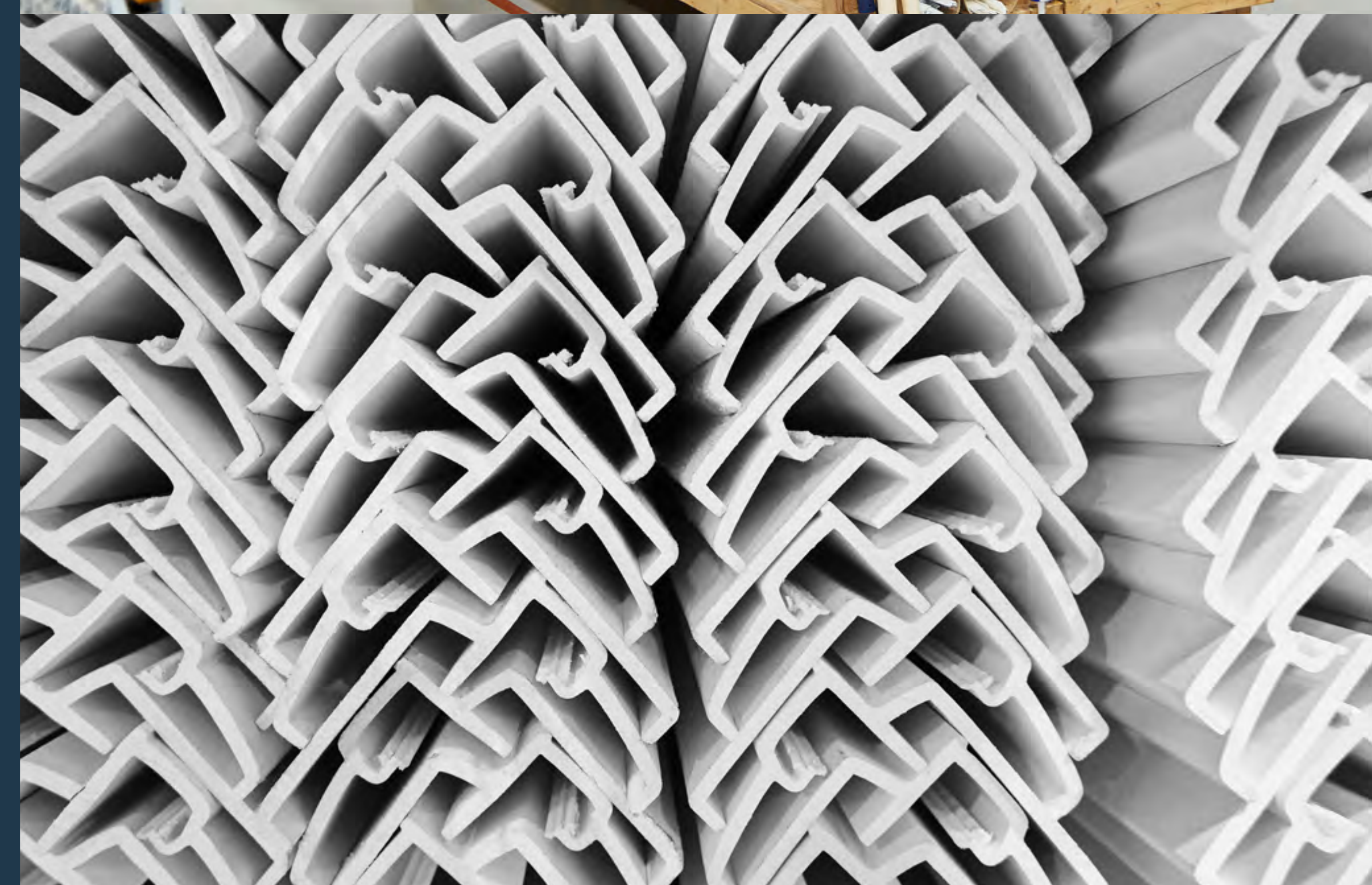
Throughout the transition, good communication with employees, customers and suppliers is key. Talk to them early about the move, so you can head off any issues before they disrupt your business. Be sure to share plans often, and be as clear as possible about what everyone can expect along the way.

An important investment

Ownership of a commercial building carries risks, but if you follow the right steps when buying the property, you can reduce those risks, profit from multiple revenue streams and grow your business.

Be proactive when you're thinking about commercial real estate, even in the distant future. Take the necessary time to make a good decision and surround yourself with an experienced team of advisors to help you navigate the complexities and risks involved.

It's challenging to find the right space, and many entrepreneurs make costly mistakes that can affect their investment and saddle them with unforeseen expenses. However, proper planning can help make sure this important investment is a successful one for your business.



BDC is here to help.
We provide business loans to help thousands of entrepreneurs just like you with their real estate purchase and advice to plan the layout, optimize processes and workflow.

- Learn more about our financing solutions
- Learn more about our advisory services

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