

## Reasons why businesses or organizations choose to rent versus own their offices



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Few businesses or organizations in New York own their office space versus renting. There are many reasons why businesses or organizations, including real estate investment, management and brokerage companies, choose to rent versus own. However, the primary reason is probably investment of capital. The down payment required to purchase an office building can be cost prohibitive or they may be able to earn a higher rate of return investing their capital in financial instruments or a different real estate asset class. In addition, an office building might have more space than a business or organization needs to conduct its core operations, and they might not be interested in being responsible for the management and leasing of the excess space. The alternative, renting, requires little capital outlay and generally no construction or management responsibilities, but offers no return on investment. However, there is a less common, and potentially more cost effective, alternative to purchasing an office building or renting office space: purchasing an office condominium unit. Office condominiums allow a purchaser to build equity and benefit from appreciation without the responsibility of managing an entire building.

Functionally and legally, office condominiums are similar to residential condominium buildings, which are very common in New

York. Like residential condominiums, office condominiums are comprised of individually owned units within a building with common areas that are jointly owned by all of the unit owners who collectively pay for their maintenance and upkeep. However, unlike residential condominiums which are commonplace, commercial condominiums comprise a very small percentage of buildings in New York, with the majority of them located in Manhattan and Queens.

The first steps in the purchase process are setting a purchase budget and identifying commercial condominium buildings located within a desired area with available units, and there are real estate brokers who specialize in this niche who can be helpful with these issues. When preparing a budget, a purchaser should consider the capital required to complete the purchase, available financing options, as well as analyzing the projected monthly cost of ownership (common charges, mortgage payments and real estate taxes: not-for-profit organizations may be exempt from real estate taxes).

Purchasers who are not familiar with the office market should be aware that it is standard to calculate prices based on rentable square feet, which is the footprint of the condominium office unit plus a pro-rata portion of the common areas of the building based on the size of the office unit

being sold. As a result, the rentable square footage used to calculate the sale price might be considerably larger than the actual usable square footage. However, this is form over substance, and the bottom line is that the office unit must be adequately sized for the purchaser's use and needs, and priced within the purchaser's budget. Once a suitably sized and priced unit is identified, the next steps are completing due diligence and entering into a contract of sale with the assistance of an attorney and design professionals.

An attorney's due diligence may consist of reviewing the condominium building's financial statements, board meeting minutes, governing documents and certificate of occupancy, and making inquiries with the seller and building management regarding current or threatened litigation and any pending building assessments and capital improvements. In addition, an attorney may work in conjunction with the purchaser's design professionals to evaluate the pro-rata share of the building's HVAC and electrical capacity allocated to the condominium unit under the condominium's governing documents to make sure they are adequate for the purchaser's intended use.

Once due diligence is completed, the parties will enter into a contract of sale. If the unit is being sold by the condominium's original developer known as the sponsor, there will be

less room to negotiate as the sponsor will not want to deviate much from its standard contract of sale form. In addition, it is standard to have no mortgage contingency clause, so purchasers must be confident that they will qualify for financing or have adequate cash to fund the purchase price balance at closing.

Purchasers should consider SBA loans to fund their purchase if they qualify, as the rates are competitive and high LTV ratios are permitted, including the financing of construction costs, which are another important consideration as most units are sold as a white box or with an existing buildout that will have to be removed and rebuilt in accordance with the purchaser's design specifications.

The construction build out process can be lengthy, and it is critical to hire experienced legal counsel and design professionals, and potentially a construction consultant, to help expedite the construction process and try to prevent costly change orders. In addition, legal counsel may be needed to effectuate an early termination or a short-term extension of the purchaser's existing lease as it is usually not feasible to coordinate construction completion with the natural expiration date of an existing office lease.

Although purchasing an office condominium unit can be a complicated process, businesses and organizations should evaluate such purchase as an alternative to purchasing a building or renting office space.

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