



Why aren't business owners buying commercial property?

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John R. McCutchen

Philip Pape, Andrew Darragh and James Ferguson show off the building in Kearny Mesa that their architectural firm acquired in a short sale.

After leasing space in downtown San Diego for more than three decades, a group of architects decided it was time to buy a building to call their own.

Philip Pape, vice president of Ferguson Pape Baldwin Architects, said his company took more than a year researching several properties before sealing a deal on a short sale, a three-story glass office building in Kearny Mesa.

It may be a good time for businesses to invest in property because...

- The price of office space is low. The average sales price per square foot for owner-user office space is \$178, compared with a peak of \$279 per square foot in 2007.
- The price of warehouse/industrial space is low. The average sales price per square foot for owner-

user industrial product is \$112, down from a peak of \$162 per square foot in 2008.

- Interest rates are low. Federally backed loan rates through the Small Business Administration are being quoted at under 5 percent, compared with an average of 8 percent over the past 10 years.
- Federal loans have special stimulus benefits. The Obama Jobs Act extended the stimulus program by covering certain borrower fees. As an example, a company getting a \$2 million loan with a traditional 7(a) loan could save as much as \$70,000 in fees if it qualifies for a Small Business Administration loan.

SOURCE: Cushman & Wakefield report on San Diego County market

“For years we’d been hopeful that we could get our own building,” Pape said. “We pretty much gutted the entire building and started over ... As architects, it’s a showplace for what we do.”

Many people say that it’s a great time for businesses to buy distressed commercial property at deep-discount prices, taking advantage of historically low interest rates and stimulus loan programs.

But despite those incentives, many small-business owners are waiting on the sidelines, said a recent survey by CIT Group’s Small Business Lending division.

There are many reasons why business owners aren’t buying. Some are gambling on prices going even lower. Others aren’t aware of stimulus loan programs that cover borrower fees and offer low down-payment requirements. In a number of cases, small-business owners have been turned down for federally backed loans because of cash-flow issues.

In the case of Ferguson Pape Baldwin, the firm secured an interest rate of less than 5 percent and a federal waiver of \$20,000 in loan fees.

The most attractive part of the deal was the price. The architectural firm paid just \$147 per square foot — 40 percent less than what the building sold for in 2007.

Grantville building sells for half off market peak

Marilyn O’Neill, founder and CEO of Nautilus Environmental, closed last week on a building in Grantville. Her company, an environmental consulting and testing firm, has 25 employees in San Diego County, its headquarters.

“I’ve wanted to do this for about five years,” she said. “You do hear a lot of nervousness in the business community (about buying now). ... At the moment, you have to be fearless.”

O’Neill paid about \$90 a square foot, about half of what similar buildings would have sold for at the peak of the market, according to her broker, Glenn Arnold of Cassidy Turley BRE Commercial (brecommercial.com). She put together an investment group to help buy it and obtained an SBA loan with 10 percent down.

O’Neill is thrilled at the chance to consolidate separate offices and laboratories that are in separate locations in Sorrento Valley. “I get to get rid of two landlords, which is fantastic,” she said.

Nautilus Environmental, which has made the Inc. 5000 list of fastest-growing companies, is investing \$1.5 million in building laboratories, including a new microbiology lab. “You want to be able to control the site and control the cost, and we didn’t feel like we had any leverage in a leasing situation,” she said.

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Pape said he's not worried about prices falling further. "We see it as a long-term investment," he said.

Why commercial property sales are slow

- Business owners are spooked because of steep price declines. They're not sure that the market has hit bottom.
- Appraisals sometimes come in too low to get a loan.
- Prospective buyers don't see much risk in waiting around.
- Many business owners can't qualify for a Small Business Administration loan, often because of cash-flow issues during the recession. SBA loans offer the most favorable terms including a 10 percent to 15 percent down payment. (Regular loans require as much as 35 percent down.)
- Business owners want to preserve their cash until the economy turns around.

Despite opportunities like those, just 6 percent of U.S. small-business owners have bought commercial property in the past two years, said the CIT Group survey.

The survey found that business owners are anxious about the economy. Financial constraints remain a significant hurdle, with nearly 1 in 5 business owners saying they could not afford a down payment for a bank loan.

More than half of those surveyed didn't understand how the stimulus program could help them get loans by requiring down payments as low as 10 percent.

WHY OWNERS AREN'T LOOKING

The CIT Group survey found that a majority of business owners haven't even thought about making an acquisition, whether it's a 1,500-square-foot office condo or a 10,000-square-foot office building.

San Diego commercial real estate brokers say that business owners are waiting because of steep price declines.

In the past three years, the average price of office space has dropped 36 percent and the average price of industrial space has dropped 31 percent, according to an analysis by Cushman & Wakefield of San Diego.

"They're still pretty cautious," said Marc Posthumus, a commercial real estate broker specializing in owner-occupied real estate. "They've seen prices come down 30 percent to 40 percent in the past two years, and they're not sure that we're at the bottom yet."

Prospective buyers don't see much risk in waiting around, said Glenn Arnold, a commercial real estate broker specializing in owner-user sales.

"They haven't seen interest rates go up yet; they haven't seen prices stabilize," Arnold said. "They don't feel that they're going to miss an opportunity."

There's also a lot of uncertainty about the direction of the economy, and some fear a double-dip recession. Some business owners would rather have cash reserves as working capital than tie up the money as a down payment.

FINANCING HURDLES

In some cases, business owners are poised to buy property but find they can't qualify for a loan, said Randy Gorman, president and founder of La Jolla Capital Group.

Gorman said that a significant number of business owners don't qualify for a Small Business Administration loan, in many cases because their cash flow took a hit during the recession.

Those federally backed loans offer favorable terms, including waived fees and a 10 percent to 15 percent down payment.

(Market-rate loans require as much as 35 percent down, which is more cash than most small-business owners can usually scrape together.)

Arnold, the broker, said another challenge in this market is that appraisals come in too low because of the prices being recorded on foreclosures and short sales.

When the appraisal comes in lower than the purchase price and proposed improvements, "the first thing it does is spook buyers, because they think: 'I'm paying too much,'" Arnold said.

There still are options, if the buyer remains interested, he said. Buyers can negotiate with the seller to reduce the price, can scale back renovation plans, or can ask the seller to "carry back" a loan. They also could try to assemble a higher down payment, he said.

WHY SOME ARE BUYING

Posthumus said the architectural firm's purchase, which was handled by a broker in his office, was an example of a smart buy.

The team at Ferguson Pape Baldwin is thriving in the new space after settling there in May. With 23 employees, the company has designed facilities ranging from libraries and civic centers to biotech facilities and zoo exhibits. The company just won the People's Choice award from the San Diego Architectural Foundation's Orchids & Onions contest for designing the Elephant Odyssey exhibit at the San Diego Zoo.

Posthumus said that companies should consider the advantages of having their own property, such as tax benefits.

"I see a tremendous opportunity for these small-business owners right now to purchase themselves real estate for first time in years," he said. "It really is cheaper for them to purchase rather than rent or lease, because of the interest rates."

Arnold said that a buyer should focus on quality while there are plenty of properties to choose from. He said that he has seen cases where buyers got a good deal because theirs was the only offer on the table.

"The emphasis should be more on getting a really good deal on an excellent piece of property versus

getting a killer deal on a property with problems,” Arnold said.

Gorman said business owners should buy property when it makes sense financially, and advised those ready to buy against waiting for prices to drop further.

“I think it’s extremely dangerous when people who don’t live and breathe this (subject) try to time the market,” he said.

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