

How Did He Sell His Business For So Much? Maybe the Real Estate Boosted its Value

BY ROBERT FRANKO

THE NEXT TIME A FRIEND OF YOURS sells his business for a huge gain, see how much of the gain is his "business value" and how much is attributed to "real estate value." In California, those huge gains are almost always real estate gains. How can you set your business up for a gain like this when you sell or retire?

The key to creating long-term real estate value in your business is owning your own office, manufacturing facility, warehouse or retail location. But how do you go about making that happen? How do you finance it, and how can you realize the value when it comes time to sell? Also, what additional risks does ownership bring with it?

Michael (Moe) and Claudia D'Onofrio recently had the opportunity to purchase an office/warehouse in El Segundo, which has been the headquarters for their Snap-On® Tools operation. Moe is one of the top Snap-On® dealers in the country. Moe and Claudia had to address a number of the issues discussed in this article about owning business real estate. When they learned that their landlord was willing to sell, they immediately lined up financing. They were pleased to learn that the building actually appraised for more than their purchase price. They were already ahead the day they closed their purchase.

This article will discuss the advantages and disadvantages of owning the real estate where you run your business. We will also explore three different forms of ownership you can use to make that happen.

Advantages of Owning Your Own Building

The first advantage is that you stop paying your landlord and start paying yourself. For most businesses, one of the largest

monthly expenses is rent. The effort you put into improving your building's appearance ultimately creates value that your landlord can use at your next renewal date to raise your rent. Keep in mind that each time your rent goes up, the value of the building is increased for the building's owner. Furthermore, any of your tenant improvements to the landlord's building are usually paid by you, but legally belong to the landlord. If you own the building, you keep all of these improvements.

Next is the pride that goes with ownership. Just like owning your own home makes you more attentive to its upkeep, owning your own building encourages

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you to invest in the appearance of the location, to make the necessary investments in fixtures and improvements to keep the location state of the art.

Then there are the tax advantages to consider. Your accountant will give you the exact details, but for starters, all of your property taxes, ordinary expenses of upkeep, interest on the mortgage and related expenses are usually fully deductible. Then you can also take a certain amount of depreciation, which further reduces your taxable income.

If the building you buy has more space than you really need, you may be able to rent out some space, which helps you to reduce your overall occupancy costs.

Typically, you can borrow at least 70% of the purchase price of your building. Using programs like those sponsored

by the Small Business Administration (SBA), you might even be able to borrow as much as 90% of the purchase price. You might be able to own a \$500,000 building for as little as \$50,000 down.

Finally, when the time comes to sell your business, your buyer will probably find it a lot easier to finance the purchase, if the business also includes real estate. You may also decide to sell the business and keep the real estate, using the rental payments to support your retirement.

Disadvantages of Owning Your Own Building

Owning real estate also comes with its own risks. Almost always your occupancy costs will initially be higher as an owner than as a renter. When a problem arises, such as a leaky roof, you can't just call the landlord. Whether you put the money into a separate account or not, you need to keep in mind that buildings wear out, so you must plan for things like repaving the driveway and replacing the air conditioner.

If you rent out part of the space in your building to a tenant, you will have all of the issues that a landlord has to worry about, such as late rent payments, noisy neighbors, and tenants who call you when the plumbing doesn't work.

Expenses such as property taxes, routine maintenance and loan payments have to be made by you when they come due. This can be particularly burdensome when your business has slowed down or your other business expenses are unusually high.

How To Buy Your Own Building

Do you think the benefits of owning your own building outweigh the risks? We will now explore three different alternatives for owning your own building. This



Michael and Claudia D'Onofrio lined up financing to purchase the headquarters for their Snap-On® Tools operation in El Segundo. The building ultimately appraised for more than the purchase price, putting them ahead the day they closed the sale.

includes individual ownership, condominium ownership and joint ownership with other business owners who have real estate needs similar to yours.

I'm Ready To Buy This Building, What's Next?

If you have decided that owning your own building is the right choice for your business, then you will want to explore these three common forms of ownership for "owner-occupied" real estate. There are other forms of ownership, but this will provide you with a good way to start thinking about taking this step.

No matter how you choose to purchase your building, you will need the help of a good real estate attorney. You will also want to explore these alternatives with your accountant.

Individual Ownership

The simplest way to buy the building may be to purchase it in your own name and then lease the building back to your business. While this may be easy, it is unlikely to be the best way. Your attorney will probably encourage

you to look into owning the real estate through a limited liability corporation (LLC). Even if you are the only member (owner) of the LLC at first, you can later sell parts of the LLC to other individuals or gift parts of the LLC to family members for estate planning. If you have partners in your business, you can keep the same ratio of ownership in the real estate through an LLC.

Your attorney should file all of the appropriate forms with the State, create the necessary operating documents, and assure that title is vested properly. Your attorney will also create a lease between the LLC and your business. All of these "formalities" are important. Your accountant can help you in this area too.

Condominium Ownership

You may find a building where individual units have already been created as condos. Most people are aware of condos for residential living, but many business owners are surprised to learn that condominium ownership is popular with business owners, and not just for offices, but also for warehouse facilities and light

manufacturing. Clever business owners have even purchased land, changed the land use for the site, gone to the Planning Commission and obtained a condo map for a site, and then sold condo units to other building owners. This is a complex process and not recommended for most business owners. If you purchase an office condo, someone else has already gone through this process for you.

An office condo allows you to buy your own office, but share the expenses of the common area facilities, such as parking lots and landscaping, with your neighbors on a pro-rata basis (that usually means you pay according to the number of square feet in your office compared to the entire project). There will be a condominium association that oversees this and you will be subject to certain covenants, conditions, and restrictions (CC&Rs), which will dictate what improvements are made to the overall structure, may include architectural oversight, and will determine what reserves must be set aside for future expenses. The CC&Rs may create a burden, but they usually result in a better maintained facility. You should have a vote in the condominium association and you may have an opportunity to serve on its board.

You will usually own the space that you occupy to the outside walls, plus you will have a right to use the common areas. Title to your own space will usually be fee simple, which means you should be able to get a loan to help finance the purchase.

Joint Ownership with Other Business Owners

A popular approach to building ownership among business owners who have similar real estate needs is joint ownership. Frequently, the business owners will set up an LLC and then they will own the LLC in the same proportion as the amount of the building they occupy. If a building has 10,000 square feet and three business owners wish to share the building, two of them occupying 2,500 square feet each and the third occupying 5,000 square feet, they could own the LLC, 25%, 25% and 50% respectively.

This form of ownership is similar to the condominium form, with certain notable differences. It is not as simple to transfer ownership in an LLC as it is in a condo. The remaining members usually want to approve the new owner. Banks will seldom finance the individual membership units in an LLC. While one member may only occupy 25% of the building, he may be responsible for 100% of the loan on the entire building (called joint and several liability in the loan documents).

Marc Moser is the CEO of Torrance Hospital Independent Practice Association (THIPA). Marc had successfully built a medical office complex, so he was prepared when some of the physicians in THIPA approached him about doing it again. Marc located a building that could be renovated to create a state of the art medical center on Telo Avenue in Torrance, right around the corner from Torrance Memorial Hospital. Marc worked together with his attorney, Doug Workman of the law firm


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Stephan, Oringer, Richman & Theodora to create an LLC, owned and leased proportionately by 19 doctors. Because the doctors are busy with their professional obligations, they appointed Marc to lead the project. Thanks to an experienced administrator and a skilled attorney, the doctors will have years of

enjoyment in a wonderful working environment. They will also realize all of the benefits of owning this coveted real estate project. Since their ownership is proportional to the amount of space they lease, they have effectively become their own landlords. A wonderful win for everyone.

What's My Best Choice?

Of course, only you can answer that question. But if you want to enjoy all the benefits of owning your business real estate, here are some good ideas for you to consider. There is probably no better time to start looking into it than right now. 

Robert Franko is the President of Beach Business Bank and The Doctors Bank, a division of Beach Business Bank. His company provides a full range of loans and deposit services for businesses, with a special emphasis on the business banking needs of doctors and other healthcare professionals.

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“ I never expected this level of service from a bank.”

MICHAEL D'ONOFRIO
SNAP-ON® TOOLS

WHEN MICHAEL (Moe) and Claudia D'Onofrio recently decided to purchase the office and warehouse in El Segundo that is the headquarters for their Snap-On® Tools operation, Claudia called Beach Business Bank. “Everyone at the bank worked hard

to make this as painless and easy as possible,” said Moe.

“I never expected this level of service from a bank, and I especially appreciated their personal attention to our needs,” added Claudia.

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