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Office condos can be a good match for some service firms

A Washington Post real estate feature last summer named Dallas, Atlanta, Southern California, Northern Virginia and New York as markets in the midst of some eye-popping office condominium growth.

Indeed, a few months later, downtown San Diego kicked off its first ground-up office condo project scheduled to go online in December 2006. Half of that development's 27 new Class A units were pre-sold. And in Orlando, one developer even boasted that office condos would be as widespread as residential condos in his state within a decade. That's a pretty lofty prediction, even by Florida standards.

Denver wasn't mentioned as one of those hot markets pegged for explosive office condominium growth. But it is evident that office condos here are finally being recognized as a viable and high-end form of small-user ownership. There is a significant increase in both new office condo construction and conversions of existing product across the metro area, and the demand will only increase as higher quality properties are delivered to the marketplace.



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Purchasing an office condo has its risks, but for the right type of user, the rewards are far too attractive to ignore. In this case, the right type of user seems to be the small, mature, well-established professional service firm with a relatively static growth pattern.

Accountants, psychologists, engineers, architects, financial planners and insurance agencies, among others, are typically the best candidates. Most or all of these types of operations have settled into their "final" business models: They have modest space requirements of 2,500 square feet or less; they have a fixed staff and don't expect to grow or move again; they have a solid and steady professional practice with a loyal clientele; and they have money in the bank. This type of successful service firm has equity in its practice and

is ready to explore the ownership option to begin building equity in its facility.

Just to be clear, the office condominium concept is actually a method of ownership, not a description of a physical property. As such, office condos are not intended to be purchased as investment vehicles. While they do build value over time, most will not yield a significant return even after five years. But they are assets, and business owners are far better off if they can show assets to offset any corresponding debt.

Office condo ownership has other significant benefits, as well. Like homeowners, owner/users of these types of spaces usually "live" in them. They're in it for the long haul. Or at least they should be. That affords owners a great deal of control over their individual spaces. They can fix operating costs and make changes to the design and finishes as they see fit. Their spaces are relatively small and they're not on the hook for maintaining the upkeep of an entire building. And, of course, there are no landlords to answer to, so owners are no longer exposed to the volatility of rental rates.

These are attractive, long-term benefits for the right kind of buyer. But there are also limitations to consider.

Office condos are fixed spaces. Blowing out a wall of an adjoining suite to accommodate expansion is typically not an option. A tenant can negotiate that kind of flexibility with its landlord, or simply move to a larger location when its lease is up. An office condo owner does not have that luxury. So a firm's space requirements must be fairly static in order for this model to work. And the potential buyer here must be financially sound.

Small users with good credit can usually qualify for an SBA (Small Business Association) loan which requires a minimum of 10 percent down. For a \$300,000 office condo, that's \$30,000 that must come out of the user's pocket before anything else happens. Conventional loans require even more down. That can be a heavy financial risk for a small business. On the other hand, part of the attraction of office condos is that the net cost of owning can be the same as the cost of leasing after tax benefits are factored into the equation.

Renters, of course, don't think about tax benefits because they don't get any. But their landlords do. That's what leasing is all about. Renters, in essence, purchase properties over time for their landlords, not for themselves. Office condominium owners build equity with their monthly payments while earning tax benefits, like deductions for depreciation and interest.

Office condos have been around for decades, mostly in the form of converted office buildings or other such underperforming properties. But that is changing rapidly. The downtown San Diego development mentioned calls for the construction of a nine-story, Class A building with street-level retail space and high-end finishes throughout. That's not to say we'll see that in Denver anytime soon. But there are new office condo developments coming online all across the metro area with an accent on very high quality. And why not? Class A space is at a premium here these days.

Professional services firms snap up Class A lease space for a reason. The quality and comfort of those offices convey a specific image which in turn inspires client confidence -- and loyalty. New and improved office condos offer that same level of quality to clients. And owners reap benefits they could never achieve with leasing.

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