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What Should You Consider Before Making a Lowball Offer on for Lease or Sale?

By Lynn Drake, Compass Commercial

Over time, I have seen that no matter which side of the table people are on while negotiating a lease or purchase, they can somehow justify a ridiculous offer. During the last recession, many landlords lost their buildings to the banks, and the banks then took ridiculously low offers just to get the property off of their books. However, most landlords can't reach into their wallets to sell you a building.

Did you know that commercial buildings have different lending rules than residential? Most Commercial Real Estate lenders require a 30% down payment on a building. The Single Business Association does have mortgages with lower down payments of 10%, but the requirements are much stricter and usually come with some hefty costs. Residential mortgages are usually amortized over 15 or 30 years, while commercial buildings are amortized over 20 or 30 years; however, the mortgage term is usually for less than 10 years. Hold that thought while we explore setting a sales, purchase, or lease price.

A building's value can be assessed based upon sales comps, the revenue stream of the building, or the depreciated replacement value. If you want to buy a building, ask your agent for sales comps or go to the city or county to do research.

Earlier this year, I had a small office building for sale. My client owned the building, and her business had outgrown it. After moving her to a new facility, the building was listed for sale. One potential buyer came back 5 times just to tour the space before he was ready to make an offer. Since we knew he was serious about buying the building, we sent him the sales comps in advance so that he could make a reasonable offer. One building comp was 5 buildings away, with similar construction, and had sold just 90 days before.

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I cringed when I saw the offer was 50% less than the asking price. When enquiring with the buyer's agent about the reason for the substantial difference, the agent replied that the buyer didn't believe the comps we had sent were valid. The comps could be verified easily with the city. We asked for the buyer to provide us with the comps used to make the offer. Of course, none were presented. He wasted my time and his listing agent's time.

Here are some facts the buyer didn't take into account. City records show when the building was last sold and the sales price. The owner had owned the building for 10 years, and the sales price wasn't much higher than the owner had paid for it originally. There was an existing mortgage on the property. It is easy to quickly calculate how much an outstanding mortgage would be on the property. The building owner will have to pay commission fees and some closing fees. A more educated buyer would have taken all of these considerations into account while reviewing the comps and made an offer that didn't cause the seller to come out-of-pocket to sell the building.

A lot of the same principles apply to leasing commercial real estate. Often, I will be working with a client who knows a space has been available for lease for some time. They believe that by offering the landlord half the asking rent/s.f., the landlord should be excited about their offer. Landlords aren't going to lease the space at 50% less than their asking rate for a couple of reasons. What the prospective tenant doesn't realize is that by accepting this low offer the landlord is devaluing the building. If other tenants believe the landlord gave someone else a better deal, they could leave or expect the same deal.

Now, let's get back to cash flow and mortgage terms. If the landlord accepts the rent at half the value, then the valuation of the building is cut in half. Every 5 to 7 years, the mortgage needs to be refinanced. If the cash flow is now 50% less than it was 5 years before, the building will appraise for 50% less, lowering the building's value significantly. If the value is too low, the owner can't refinance the mortgage. This is a simplified explanation of what happened back in 2008-2010.

In Summary:

Put yourself in the owner's shoes before making a CRE offer to lease or buy.

Low Rent/S.F. = Low CRE Valuations

Low Ball Offers = Wasted Time

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