



# 9 TIPS FOR COMMERCIAL REAL ESTATE DUE DILIGENCE



# INTRODUCTION

Like any decision you make with your business, doing due diligence before purchasing commercial real estate is critical. Your success is important to us, and we want to make sure you've considered all the angles. That is why we've put together a list of 9 important things you will want to think about before purchasing real estate for your business. We recommend that you first consult with your legal and tax advisors to help decide whether owning commercial real estate is right for you.

## 1 Can you afford to buy now?

The first question to ask before you purchase commercial real estate is “can I afford this?” Make sure you have proven a successful business model and that you can sustain mortgage payments and other associated costs for the duration of the loan. One way to evaluate this is to determine your debt service coverage ratio.

While each property and purchasing situation is unique, some of the factors you may want to consider are having cash on hand for a down payment and earnest deposit, and the potential expenses for immediate repairs or updates. It is a good idea to work with your business partners, including CRF, to decide if you are in a good position to purchase commercial real estate.



## 2 Define your reason for buying

There are many reasons you might want to purchase commercial real estate. Whether it's a larger space to scale your operations, the ability to rent to other businesses, or simply to build equity – it's important to define your purpose.

We recommend that you outline your business goals for the future and the results you hope to achieve by purchasing commercial real estate. This will ensure you have a plan in place to guide your decision and maintain a visible path toward success. If you need assistance in this process, you can always contact your CRF partner with any questions.

## 3 Surrounding yourself with the right experts

Commercial real estate is a major purchase, and you certainly don't want to do it alone. That is why it's important to surround yourself with people who bring different areas of expertise to the table.

Real estate brokers are licensed professionals who maintain ethical standards and help facilitate the transaction between buyer and seller. There are real estate associations in every state with brokers who can assist you in your search for a property. You may also want to consider consulting with a real estate attorney and an accountant.



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## Location

When it comes to real estate, there's an old saying that goes, "location, location, location." This is one of the most important factors to think about when finding the right property for your business.

If you are operating a retail store or restaurant, will there be sufficient foot traffic to generate consistent business? Are you going to need a parking lot, or be near a major highway or public transportation for customers to access your business?

Look at the surrounding businesses. Are they complimentary of your business or are they off-putting? Is there stiff competition in the area or are you providing a new in demand service for the community?

These are some of the questions you will want to ask yourself when scouting locations. A real estate broker may be able to help you in this process, and if you are planning to open a franchise, the franchiser might also have some ideas for a good location.



## 5 Physical condition of the property

It is very important to assess the physical condition of a property before making a purchase. Failure to do so could lead to obstacles, expenses, and legal restrictions that could set your business back in a significant way.

One of the first things you might consider doing, especially if you are purchasing an older building, is to conduct a property condition report. This will help you evaluate the current physical condition of the property and identify issues. We recommend consulting with your business advisors first as obtaining a property condition report may require third party assistance and may potentially be expensive. You may also need to work with the seller to set up a walk-through of the building.

Another important consideration is the building's zoning laws and if they are conducive to the type of business you are operating. Depending on your lender, a survey may be required to confirm basic information about the property. We recommend that you review zoning laws and requirements with your attorney.

There are also some pretty basic questions to ask as well. Does this space meet your current operational needs? Can it sustain operational needs if your business grows? Is there significant deferred maintenance that will require immediate attention? It's important to answer these questions in the due diligence process.

## 6 ADA Compliance

As a commercial real estate owner, it is your responsibility to ensure the property is compliant with the Americans with Disabilities Act (ADA). The ADA is a federal requirement, and you will not be able to operate your business without meeting these standards.

When inspecting the property, you will want to find out if it has all the necessary handicap accessibility features required by law, or what features need to be added and the associated costs.

## 7 Stress Test

The economic conditions in which you purchase your property are not set in stone. Things like interest rates, taxes, and vacancy rates will inevitably change. It's important to analyze different scenarios through a stress test to gauge whether your business can withstand these variables.

After conducting a stress test, determine whether your commercial real estate purchase will be an asset or a burden in the event of an economic downturn. Another consideration is rising interest rates and how they might impact your business.

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## Make sure you get the right property and the right deal

Don't be afraid to spend time touring different properties. This is a major purchase that will impact your business for years to come and you shouldn't feel like you need to rush into a decision. Even if it takes longer than you anticipated, find the right property.

Also, consider the offering price. Does it make sense? Be sure to review the terms of the deal carefully and don't be afraid to negotiate. Finding motivated sellers is important, and just because you have found the right property does not mean it is the right deal.

When performing your due diligence around the building's history, find out if there were any previous business failures and how that relates to your business. Did the previous business file bankruptcy? Is there something about the property or the location that led to past failures and is indicative of future problems? Working with a commercial real estate broker can help you answer these questions.





## 9 Plan an exit strategy

It may seem counterintuitive during the purchasing process, but you will want to think about eventually selling the property and how it will fit into your short and long-term plans.

The pandemic has shown that situations can change in the blink of an eye. In planning a potential short-term exit strategy, consider how owning commercial real estate will not only impact your business, but you as an individual. Will this property be an asset that you can utilize to help you through difficult situations, or will it weigh you down?

In the long-term, you may want to consider how long you wish to own this property. If you eventually decide to sell your business, will you sell the property as well or continue to lease it to the new buyer? When planning an exit strategy, you may want to consult with legal experts and accounting professionals.





# CRF IS HERE TO HELP.

Talk to a CRF small business lending specialist if you have questions – we'll provide answers and guide you through the process every step of the way.



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