

No buildings available? How about build to suit?

COMMERCIAL REAL ESTATE

Negotiations are underway as we have a signed letter of intent for a large logistics building outside the South-ern California basin.

Our client plans an expansion of his operation into this location. The lure of less expensive land and fewer city restrictions hooked us. The lack of supply nearly capsized us until we decided to buy land and build. This is also called build to suit. Recently, we sold a building out of the state of California. Our client is an investor who bought the Texas building in a tax-deferred exchange. Cash flow, ease of management and the multiyear lease had appealed to the buyer. For the next 10-plus years, our client will enjoy rent payments.

The building is leased long-term to a Fortune 500 company. A build to suit was accomplished for the tenant four years ago.

So what is build to suit and when should one be considered? I believe one or more of the following circumstances would dictate building new vs. buying or leasing an existing building.

Lack of availability

Industrial vacancy in Orange County is the lowest in history. Some 99.5 of every 100 manufacturing and warehouse buildings are occupied. And if your desire is Class A, in many cases there is no supply. If your company needs to grow into a larger building, chances are you'll be hard-pressed to find one.

The lack of available buildings should suggest a good climate for a build-to suit transaction.

The trouble is there is very little undeveloped land in the county. Even if you wanted to build, no vacant land exists to accommodate such a feat.

In the case of the Texas building mentioned above, there were no vacant buildings within the desired city, but there was a surplus of affordable and available buildable land sites. Thus, the choices were to build or consider another city.

Special-purpose building

suit.

- Complete understanding of the mechanics. The basic structure is: land is owned or purchased, new construction is planned and permitted, building is built and new construction is occupied. Easy, right? Yes, if you own the land, already have the plans drawn and permitted, have a bucket of cash to spend on the construction and don't need the building for several months. Complexity is added with each unchecked box.

- Financeability. You need to understand how the financing of a build-to-suit works. I could write an entire column on this subject; however, some of the highlights are: vacant land will generally need to be bought with cash, a construction loan will precede the permanent loan, a couple of appraisals may be needed, landowners won't allow their loan (if seller-carried) to be junior to a construction loan. Are you confused yet? Exactly! It's not a simple transaction.

- Understanding you will pay more. I would encourage you to take a look at the reasons you will pay more to occupy a new build versus an existing building. In short, the reasons include land prices, soft costs, entitlements, time value of money, financing, economies of scale and market forces. *Allen C. Buchanan is a principal with Lee & Associates Commercial Real Estate Services in Orange. He can be reached at abuchanan@leeassociates.com or 714-564--*

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When the inventory of usable industrial warehouses wanes, some owners will find land elsewhere and start

This is similar to the circumstance of “lack of availability” yet very different. If you are patient, and occupied buildings are present in your market, eventually one will lay fallow, create a vacancy and need a new occupant.

work on a “build-to-suit” basis.



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A special-purpose building has features that don’t exist in the market such as a warehouse with 40-foot ceilings or a building with acres of excess land for outside storage, maybe one constructed to store highly combustible or explosive contents.

Our Texas building required two of these: very high ceilings and acres of excess land for expansion and trailer storage.

A unique deal structure

Recently, a grocery distributor required a Class A warehouse building in a size that didn’t exist in the city it desired.

Additionally, the occupant wanted to own but couldn’t afford to buy land, build the building and carry the debt on a building under construction it couldn’t occupy until completion.

The solution was to interject a developer who bought the land, built the building, leased the building to the grocery distributor and granted the occupant an option to buy the building once completed.

But be wary of the following issues.

- Lots of lead time. Few if any occupants can predict their space needs two to three years in advance of a move. However, you must allow this much time to complete a build to

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Sunday, 06/19/2022 Page .Y008

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