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DECEMBER 2025

Industrial Flex Building Investments

A high percentage of speculative low-rise industrial buildings today are flex buildings, making them a good investment. One of the most appealing aspects of flex space lies within its ability to customize. For example, if a tenant wants to increase their office space or warehouse space, they are easily able to do that with flex space due to the reduced improvement costs. A flex building also allows for the tenant to have more choices in the type of space their company needs now and in the future at a more affordable price. Developers are favorable toward the flex building, as it will meet the needs of many modern sophisticated industrial building users.

The flex building is a speculative, low-rise (usually one-story), single or multi-tenant building that will accommodate different amounts of backroom and office needs, depending on particular tenants' needs.

Another benefit is the vast diversification of its tenant mix. Unlike multi-tenant office buildings that are catered only to businesses such as law firms, insurance companies, financial institutions, etc., flex assets have tenants that range from construction companies all the way to retail-style restaurants. The customizable build-outs allow for a strong mix throughout each flex industrial park that normal multi-tenant office buildings would not be able to accommodate. As a result, landlords are mitigating risk by having a wide range of diversified national and local tenants throughout their business parks.

The developer finishes the exterior of the building, the interior remains only partially completed until the tenant signs the lease. The interior is then customized to provide space which might be for light manufacturing, research and development, warehouse and distribution, sales and accounting, or inventory control office space.

In existing flex buildings, 50% or more of the interior space may be used for offices. As a 100% office, the building is a low-cost all-office alternative to the low-rise office building.

Flex buildings usually have standard attributes that will help control construction costs. These are:

- A ceiling of 16 to 22 feet. This will handle practically any manufacturing, distribution, or office operation.
- A modern HVAC system that will provide zoned temperature control capability, advanced security measures, and "clean" atmospheres throughout.
- Enough parking space. Loading docks that can adapt to any tenant's needs. Driveways arranged for easy access for trucks of all sizes.

Because the flex building is attractive to a wide variety of tenants, the speculative builder can expect to find:

- Favorable financing costs, since lenders look more favorably on flex buildings than the standard industrial building.
- Since there is a larger pool of potential tenants for the building, there should be a faster lease-up.
- Lower construction costs. The staged construction will eliminate costly and time-consuming rip-outs of already installed interior spaces that will not meet the needs of a new tenant. Later expansions of tenant spaces are easily handled (at lower cost) because of the flex design features. With this many attributes, the flex building has the making of a very good real estate investment. ❏

Land Development Agreement

The acquisition and improvement of land is a large-scale operation and requires large amounts of capital. This has created methods of land acquisition that gives the developer access to and control over a large enough tract to make development economical without requiring an initial outlay of all of the capital necessary to acquire such a tract.

From the point of view of the landowner, the disposal of a large tract at a good price may require a formula that will encourage the developer to commit improvement and development money for part of the tract that will build future value into the entire tract.

This may be accomplished by the following:

- The developer sets up a master plan that sets forth the general scheme of development and submits it for the approval of the owner.
- The developer and owner enter into an agreement setting forth the acreage prices for the entire property.
- Owner and developer agree on the number of years over which the full development is to be completed.
- To protect the owner against freezing of his property, the developer firmly commits to buy a predetermined number of acres each year.
- If the developer fails to meet this schedule, the owner is released from his commitment.

Development Agreement

Another way of handling the problem is for the developer to share the net profits from the land development with the landowner. This can be done by a "land development agreement" in which the developer agrees to perform the platting, the laying out, the installation of lot improvements, and the promotion of the subdivision. The landowner agrees to accept a percentage of the sales price of each lot, with a fixed minimum guaranteed. For example, the developer agrees to pay net to the landowner 25% of the sales price of each lot sold, with a minimum of $50,000 per lot.

With this kind of arrangement, it is important to protect the landowner from finding his land cluttered up with liens left by a subdivider who became insolvent. The landowner should consider confining the developer or subdivider to a small tract of land at a time and give him "rolling options" to acquire additional parcels at intervals over a period of time. Failure to keep up with this purchase program results in loss of future options. The land that has been optioned but not purchased is not subject to liens against the developer.

Liability for Not Proceeding

In one case, a jury found that a village breached its contract with a real estate developer calling for the village to acquire property and convey it to the developer for construction of apartment houses and a shopping center, all conditioned on obtaining financing from HUD. The village repudiated its explicit undertakings, to acquire and convey property to the developers. HUD had granted the main application and was in the process of considering the other grants involved, so the village could not back out of its promise. [Heritage Commons Partners v. Village of Summit, 730 FSupp 821, (ND Ill. 1990)] ❑

The CPI Escalation Rental Clause

Putting a CPI (Consumer Price Index) escalation clause in a lease is to make the lease fair to both the tenant and the property owner.

A primary benefit of escalation clauses is they help protect against diminishing purchasing power related to inflation. The CPI measures monthly the average change in the prices consumers pay for certain goods and services such as oil and gas, healthcare, food, and housing.

Commercial leases commonly provide that while rents will follow the CPI upward, they will remain the same when the CPI goes down. Landlords will argue that this is necessary because the CPI rarely declines and the one-way provision is necessary in leases when the owner obtains financing.

CPI clauses operate in one of two ways in the calculation of annual changes. Most common in use is the "yearly method". At the end of the year, the rent is increased by the amount of the increase in the CPI in the previous year. So, the rent each year is raised to a new level and this is the basis for the next year's adjustment.

The other method is the "cumulative method." Using this, the initial rent (at lease commencement) is increased each year by the change in the CPI between the beginning of the lease term and the current year. In other words, each CPI adjustment reflects the cumulative CPI increase since the beginning of the lease term.

When the CPI rises steadily throughout the lease term, both methods yield the same results. However, if the CPI declines in a year and then increases in the following year, and if the lease contains a one-way provision, the cumulative method favors the tenant. This is because using the cumulative change in the CPI means that declines are included as well as increases in the total. By comparison, under the yearly method, the tenant loses the benefit of a year in which the CPI has declined. ❑

The Conversion Of Railroad Stations

The once abandoned small town railroad stations, which were once the busiest and most accessible buildings in a city, are no longer deserted and deteriorating but have been converted to shopping centers, entertainment venues, and hotels. Stations along commuter lines in smaller towns are being used for small cafes & coffee shops, a flower shop and assorted businesses to take care of the needs of the commuter.

Things have been changing along the old rights-of-way. Former railroad depots have been fixed up and now serve as retail furniture stores, antique or gift shops, as restaurants, even beauty salons. When the building has burned down or has been demolished, the area has often has been converted into commuter parking space.

Among the larger vacant train stations, the plan is to facelift the historic structure and redevelop the space into hotels, offices, stores and parking garages. For example, the St. Louis Union Station has undergone a $135 million renovation and now includes entertainment areas for cultural activities, specialty retail shops, restaurants, and a 550-room luxury hotel.

Old train stations have been involved in a re-awakening of redevelopment interest. Mass transit experts, community leaders, and real estate investors have been planning on how to use an old railroad station to liven up a whole section of town. Developing the railroad station can encourage other new real estate ventures in the nearby area. ❑

Physical Inspection Of Investment Property

When a buyer makes an offer on an investment property, it is usually only after a thorough inspection of all of the data that is available on the financial records of the building. The physical inspection of the property could be as important or more important than the rents and expenses.

Some investors pay more attention to the data than the structure. With a physical inspection on the potential investment property, a buyer may be able to:

- Work out a better price.
- Get ready for any upgrading or maintenance expenses.
- Avoid catastrophic repair bills for detectable problems.
- When actually purchased, get a higher return on the investment.

Where to Start

First, the investor needs to know what experts to call. He needs to know what needs to be inspected and how to do it. The property must be verified as physically sound and is a worthwhile investment.

There are some broad categories of problems that investment properties are subject to, and the type of expert that is needed for the inspection.

- **Soil Conditions.** When a property is located on certain types of land, a professional soil engineer or geologist should be called. Property could be low lying or reclaimed land; a former landfill or dump area; on hilly or mountainous terrain; located at lakeside or seaside; has structures or piers, pilings, stilts, or other unusual foundation conditions. Is the actual foundation of the building dry and clean with no holes or cracks.
- **Drainage.** If the property is located within a flood plain area, it should be carefully examined by a civil engineer. The buyer can check basements and interior walls for signs of water damage. Also an inspection of the plumbing system for any signs of leaks or signs of old leaks.
- **Elevators.** If the property has an elevator, has it had the proper inspections in recent months? Elevators and electric systems should be inspected by professionals in those fields.
- **Fire Suppression System.** Is the fire system inspection up to date?
- **HVAC.** Representatives of the companies that manufactured or installed the heating, ventilating, and air-conditioning systems.
- **Roofing.** A roofing consultant or structural engineer should be called to determine age, condition, ability to withstand loads, etc.
- **Pests.** Pest control companies are able to check for termites and other damage-causing pests.
- **Environmental Inspection.** Check for contaminants on or near the property.

Government Records

Check the local building department and see what permits were issued and when. Some records may also show when fire inspections or health and safety inspections were made. Any violations will be on record.

The plans and specifications of the building may also be on file. These may contain the names of the original architect, engineer, contractor and developer. The investor may wish to contact one or more of these if any questions need an answer.❑

The Right Kind Of Investment

When an investor has searched for new real estate investment opportunities, finding and evaluating them is becoming more sophisticated and complex. Today's investor in real estate must have a grasp of market conditions and potential that is usually beyond their own available time to attain.

A prospective investor may have many questions about what kind of investment is right for them. The answer to these problems can be an interview with an interested professional real estate broker who can act as a real estate investment counselor. A prospective investor can be interviewed in depth to find out their specific needs and wants in an investment property. At the same time their needs are being evaluated, the broker will also communicate what benefits are available in various properties and how to identify them.

Some considerations should be given to the risk of loss for each age bracket of investor. Should an older investor purchase a property with the smallest down payment and highest leverage position? This will limit cash flow and may cause the property to have a "negative" cash flow. Is this what they want–or do they want cash flow from the property?

How about the younger couple? Are their objectives for long-range estate building or for current cash flow? Would they be more willing to take chances with a marginal investment that might bring big returns later?

These answers must be decided by each investor for himself or herself. But, only after enough information has been furnished so that an intelligent decision can be made.

When a new investor has a better idea of the type of property that will do the right job for him/her, then and only then should they be exposed to the market place and shown specific properties. Now the investor or investors can evaluate the various benefits and risks for the information shown on each property and apply the information to their own situation.

What is right for you? A new rental unit? A strip center? A one-hundred unit apartment property? An Outlet Center? Perhaps you should have five or six apartments or commercial properties in scattered locations. Real estate counseling can show you that you can choose which is right for you and know the reasons why it is right! ❑

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