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Contents

- Commercial Condo Or A Separate Building
- Unusual Parcels Of Real Estate
- Problems With Rent Free Concessions

- A Step-Down Rental
- Student Housing Solutions
- New Tenant Screening Process
- Commercial Real Estate Representation

Commercial Condo Or A Separate Building

Which is the better investment — a separate (single) commercial building or a commercial condominium within a larger complex? Each has its own unique set of attributes, and so the answer really depends on the needs, goals and characteristics of the investor.

Comparison

Below is a comparison of each building type based on certain property characteristics, which hopefully will shed some light on the right property profile for your situation.

A freestanding building is owned by a single entity (be it a person, couple, corporation, etc.) and it sits on an individual parcel with separate legal access. The most common freestanding buildings are single-family residential homes, or commercial office buildings.

A commercial condominium is an individually owned unit that is part of a larger multi-unit building with various owners. Each condo owner receives fee simple title to their unit along

with a recordable deed. A condo owner also receives an undivided interest in the common areas of the project, including the hallways, parking areas, landscaped grounds, entrance or lobby. Each condo is assigned its own assessor parcel number, allowing property taxes for the entire complex to be assessed individually to each unit based on that unit's particular value. Condos can be bought and sold in a manner similar to that of freestanding buildings.

Management

A freestanding building is generally managed either by the owner or by a professional property manager whom the owner must hire and compensate. A condo complex is typically managed by a condominium association comprised of a small proportion of the condo owners chosen to represent the entire project. This "owner's association" (OA) may also choose to contract with a professional manager. Investors or owner/occupants who want nothing to do with managing or keeping

up their property may want to seriously consider condo ownership, as these tasks can be completely handled by others.

Property Operating Expenses

Many investors balk at purchasing a condo when they hear that, in addition to their mortgage payment, they will have to pay monthly Owner Association dues. However, association dues are simply a compilation of certain property operating expenses, such as landscaping, interior and exterior maintenance, fire insurance, utility expenses, parking areas that would be equally present in the ownership of a freestanding building. Although Owners Association dues of, say, \$300/month for a 1,500-square-foot office condo may seem expensive, this amount could very easily be less than the cost for the same expenses in a comparable freestanding office building. Before discounting a condo based on OA dues, a comparison of operating expenses should be completed.

(continued)

Decision Making

Due to the cooperative nature of condo projects, decisions regarding maintenance, capital improvements and other financial actions are necessarily relinquished to a representative Owners Association body. Independent investors who prefer to handle their own management may not be well suited for condo ownership. On the other hand, a well-run OA will budget for necessary expenses and reserves and will keep the property well maintained and running smoothly, thereby maximizing each individual unit's

value. A walk around the condo project and a few conversations with existing owners are highly recommended prior to purchasing a commercial condominium, as this will give you a very good sense of whether the OA is functioning properly.

Cost and Appreciation

Because of lower per-unit construction costs and shared common areas, condos are generally less expensive than freestanding buildings. By example, a 3,000-square-foot industrial condo would generally cost less than a 3,000-square-

foot freestanding industrial building in comparable condition. Therefore, if funds are tight, condos may provide an easier path to ownership. Will they appreciate as much as freestanding buildings? This is a very difficult question as the answer depends on numerous factors, including how the project is run and maintained. In observing commercial condo prices over the last 15 years, they generally tend to mirror the movements of their freestanding counterparts and will typically appreciate (and depreciate) in a similar fashion. □

Unusual Parcels Of Real Estate

In many metropolitan areas, commercial land for development is in very short supply. Developers are converting older warehousing to shopping areas, demolishing existing buildings to build new projects in areas in transition. However there may be many hundreds or even thousands of unusual parcels of property that have been overlooked. Many are ready for commercial development close to downtown areas, suburban commercial developments, and densely populated areas. Owners of many of these properties consider the property as "surplus" and have not considered development.

Some of these properties are in the inventories of city, county and state ownership and are surplus parcels that were unused in street, highway and freeway development. Others are owned by railroads.

All of these infill properties have one thing in common—they all are unusual pieces of real estate. They are peculiar shapes

and sizes. One railroad parcel was 50 feet wide and 26 miles long. This parcel lay unused for many years until a developer utilized parts of it for several self-storage projects. The developer formed a joint venture with the railroad, with the railroad contributing the land and the developer contributing his self-storage development expertise.

Goats For Rent

An unusual property was a weed infested vacant piece of land that was converted to a pasture for the business of raising goats. The goats were then rented out by the "farmer" to clear areas of overgrown invasive plants, hillside areas difficult to clear brush, and for clearing undergrowth for fire prevention in remote areas.

A stunning restored seed mill, with 1950's charm & business potential, which had been vacant for several years, was converted to a multi-use center housing an upscale restaurant, micro brewery and bakery, an Art gallery, and a gourmet grocery store,

Throughout the country now there are shopping centers built under freeways, commercial buildings erected in the unused areas under bridge approaches. In some states, the air space above busy highways is leased to restaurants or other businesses that can be used by people that see it while going to work, driving by every day.

One real estate broker contacted a railroad about surplus property in his area and was handed a stack of descriptions of over forty properties that were available. No one at the railroad was doing anything about marketing these properties but a business potential was waiting for a creative developer to come along and turn the unused property into a treasure.

When you see an unused parcel of land in your area, let us research it for you. We may be able set up a purchase, lease or joint venture that can change that eyesore lot into a major development. □

Problems With Rent Free Concessions

Commercial property goes in cycles from full occupancy to overbuilt with vacancies. When it has been difficult to rent, various concessions have been made to get tenants in and paying rent.

Free rent concessions have been used sometimes to help fill a building. This may have created more problems than it solved.

As an example, suppose there is a building where office space is offered at \$25 a square foot on a five-year lease. The lease can be renewed for an additional five-year term at a negotiable

renewal rate. To get tenants into the property, the owner gives a concession of free rent for the first two years. This may sound like an acceptable, though extreme solution, but might not be good for either the owner or the tenant.

The bookkeeping and tax preparation for these two years can be a major problem for both the tenant and the owner.

The landlord has no income from this tenant during the two-year period of the rent concession. This can create a cash flow problem for him,

The tenant's cash flow is incredible during the first two years, since he is paying no rent at all. Then it jumps up to the \$25 a square foot level for the remainder of the lease. This can cause a cash flow crisis for the tenant.

Since the property has such a severe vacancy problem that the owner considered the free rent concession in the first place, he might consider a new manager, or a sit down session with the current manager on how to solve this vacancy problem with some creative ideas other than free rent. □

A Step-Down Rental

Tenants understand the need for step-ups in their leases because they recognize the inevitable upward trend of costs. There is no reason for elaborate set of definitions in the lease. The lease simply needs to spell out in a schedule the applicable period and the rent to be paid during that period.

The landlord will almost never agree to a step-down rental tied

into the possible deflation rather than inflation. However, there is one instance where the demand of the tenant for a step-down in the rental might be appropriate.

When a landlord has been able to get good mortgage financing for the improvement primarily because of the high credit rating of the tenant, that tenant may argue that when the initial mortgage is fully paid off, the rental should

be reduced. The cash flow to the landlord will jump substantially because the debt service is eliminated and the tenant may want a share. In effect, the tenant says that since his credit standing made the mortgage possible (and consequently created desirable leverage for the owner), the tenant should benefit as well as the owner when the mortgage is paid. □

Student Housing Solutions

When an owner has an apartment property near the campus of a University and they mainly rent apartments for student housing, there are particular problems. The competitive situation dictates that leases be offered for one semester of nine and a half months. A twelve-month lease for students is virtually unheard of. That means there are lots of vacancies as soon as final exams have ended. (This does not apply

to a few University communities where there is always an apartment shortage. In those few places, the student must lease for 12 months or have no lodging.)

There are ways that might help turn the months of vacancies into extra rental income.

First, during graduation week, the vacant apartments are rented to parents and guests, by the management company, on 3-day or 5-day leases. The parents like

being closer to the activities and a close place to rent is more attractive than an outlying motel or hotel.

Second, summer students taking courses at the university welcome the chance to rent an apartment on a week-to-week basis. This is particularly true of students and employees from other colleges who don't have the time to search out living arrangements for, say, a six-week summer course. □

New Tenant Screening Process

The property manager provides the tenant applicant with the lease application that must be filled out for the interview. A leasing agent may assist during the review process, but the final selection of tenants is ultimately the property manager and owner's responsibility.

All leasing personnel should be informed that the company does not discriminate on the basis of an applicant's race, sex, color, creed, or national origin.

The screening process helps determine the prospect's desirability and verifies financial and nonfinancial qualifications. When all information has been received, the applicant's file should be given to the property manager and/or

owner for final review. Decisions made during this process are based on the following criteria:

- Impressions created by the prospect when interviewed;
- The prospect's employment history if the prospect is applying for residential space; company or business history if the prospect is applying for commercial space;
- Information gathered from verifying the prospect's references and from the completion of a credit check;
- Compatibility of the tenant to the property type.

When the application is approved, the property manager should prepare the lease and other

appropriate documents that require the applicant's signature. Commercial tenants will probably have an attorney review the lease, which may require a certain amount of negotiation. Upon approval, the lease is signed, and security deposits and rent payments are collected as specified in the lease.

When an applicant is disapproved, he/she should be promptly notified. If the disqualification resulted from a credit check, the law requires that the applicant be informed of this. To protect against possible litigation, rejected applications should be kept on file with complete statements about why applications were rejected. □

Commercial Real Estate Representation

There are a number of ways to buy, sell or exchange investment or commercial real estate. Having the knowledge of what you can do in some tax situations can be the difference between an annual profit or loss in a property that you intend to acquire or one that you already have in inventory.

The professional commercial real estate broker is in the position to represent clients in real estate transactions by setting up sales, exchanges, leases, purchase and sales of options, and management of real estate.

A professional real estate practitioner must stay aware of current tax laws and court decisions in order to structure transactions, but does not give legal or tax advice (unless he/she is also an attorney or a certified public accountant). In any complex transaction that might result in changes in any owner's legal or tax situation, the other members of the "consulting team" should be the owner's attorney and CPA. We always recommend meeting with these other professionals during the planning and closing of major real estate transactions.

As commercial brokers, we are part of your professional team. It is our job to create the real estate transactions that will be needed to enhance your estate. We should meet with our clients on a regular basis to evaluate their present position in properties, reviewing plans for future acquisitions or exchanges.

Reviewing your plans and goals can give us the information needed to help us in moving you in new directions as soon as possible, using purchases, sales or tax deferred exchanges. □



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A CCIM is a professional real estate practitioner with proven technical expertise in commercial property. A CCIM is a person truly committed to the fundamentals of effective commercial-investment brokerage. The CCIM has completed a full schedule of Post Graduate Level Courses in investments, taxation, development and marketing all types of commercial-investment properties. The designation of Certified Commercial-Investment Member is unquestionably the highest degree awarded in the commercial-investment real estate practice.