Due Diligence for Commercial Condominiums

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The acquisition of a commercial condominium unit requires extensive due diligence in determining the permitted use of the space, the financial stability of the investment and the terms of its current use (if being rented out). A commercial condominium building is in many ways structured the same way as a residential condominium building. The building will have a board of directors which is elected by the unit owners and will keep minutes of the board meetings. It will have an offering plan for the building and maintain annual audited financial statements. In conducting our due diligence, we must review each of these documents as well as any current leases for the unit (if occupied) and the certificate of occupancy for the building.

In the acquisition of any investment property, the first question which must be asked is "What is the purchaser's investment objective?" Purchasers of commercial condominium units are usually either owner occupants or investors who desire to rent out the unit and act as a landlord. Not all commercial condominiums permit the units to be used for any commercial purposes. For instance, the certificate of occupancy for some commercial condominium buildings will be limited to "art galleries" or can be something as general as "offices." You must look at the zoning classification and also review the offering plan to see what the permitted uses for the units are according to the condominium association.

A thorough review of the audited financial statements and board minutes for the building are the most important aspects of due diligence in ascertaining the financial health of the building. If your client is an investor, they have a projected return in mind when they are analyzing a commercial condominium unit and, even if your client is going to be an owner occupant, they also have a bottom line for the carrying cost of this property in making their decision whether to purchase or not. The financial statements for the building will outline the statement of operations indicating where the condominium is deriving its revenue from and what expenses it is incurring. The vast majority of the revenue in a commercial condominium comes from common charges which are paid by the unit owners. You ideally want to see the building operating at a small surplus in order to have excess funds on an annual basis to put into their reserve fund. A building which operates at a minor deficit is not necessarily a red flag. If a building has a healthy reserve fund, it can sustain a minor deficit. Additionally, these buildings are not meant to turn around a substantial profit. If they do, they are likely poorly managed properties as the only reason for this can be that common charges are too high which has an adverse effect on the value of the properties. We then review the board minutes to see if there are any upcoming expenses that may result in an increase in common charges or an assessment.

The offering plan in a commercial condominium is very similar to that in a residential condominium. It provides all buyers with disclosures and protections as required under the Attorney General's regulations. The main items to review in the offering plan are the permitted uses of the units, any restrictions in subletting, disclosure of lot line windows and a summary on common charges and property taxes. If a purchaser is buying directly from the developer of the project, you will also need to review the section in the offering plan breaking down all of the closing costs, as closing costs in a new development project are always higher than in a resale project.

If a unit is currently occupied by a tenant that is not the seller, we must review the lease between the seller and the current tenant. Keep in mind that if you purchase a property with a tenant in place, the buyer steps into the shoes of the landlord and assumes all of the liability moving forward for the space, the tenant and the lease. We review the lease to determine: that the cash flow being advertised is accurate; outline any renewal options the tenant may have under the lease, the proportionate share of real estate tax increases for the tenant; the expiration of the lease; and any rights of the tenant to assign the lease. All of these factors will have a significant impact on your client being able to achieve their investment objective and also factor in their calculations of their projected return on the investment. We then synthesize all of our findings from our due diligence in a PowerPoint presentation which provides the purchaser with all of the information they need in order to make an educated business decision on this investment.

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