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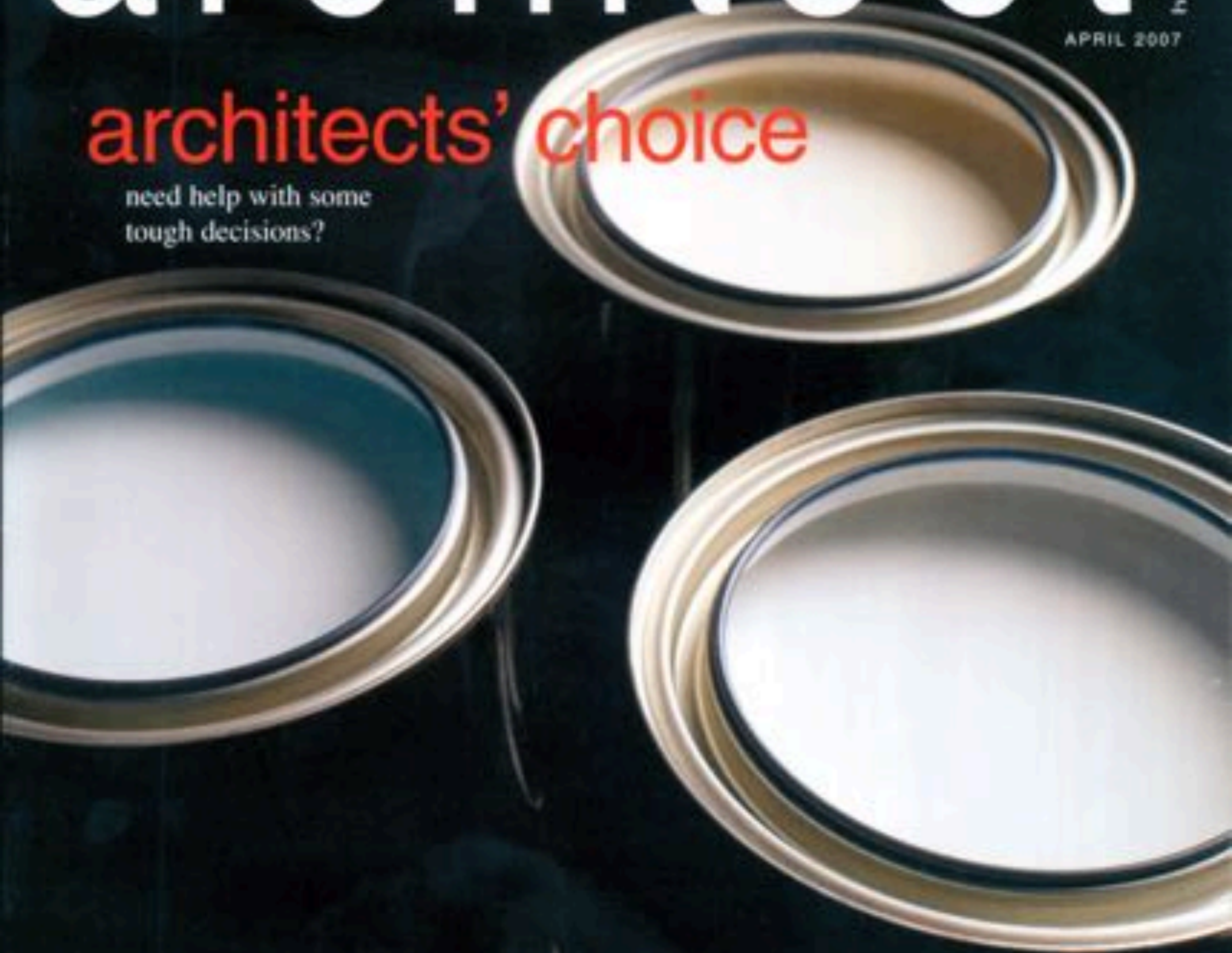

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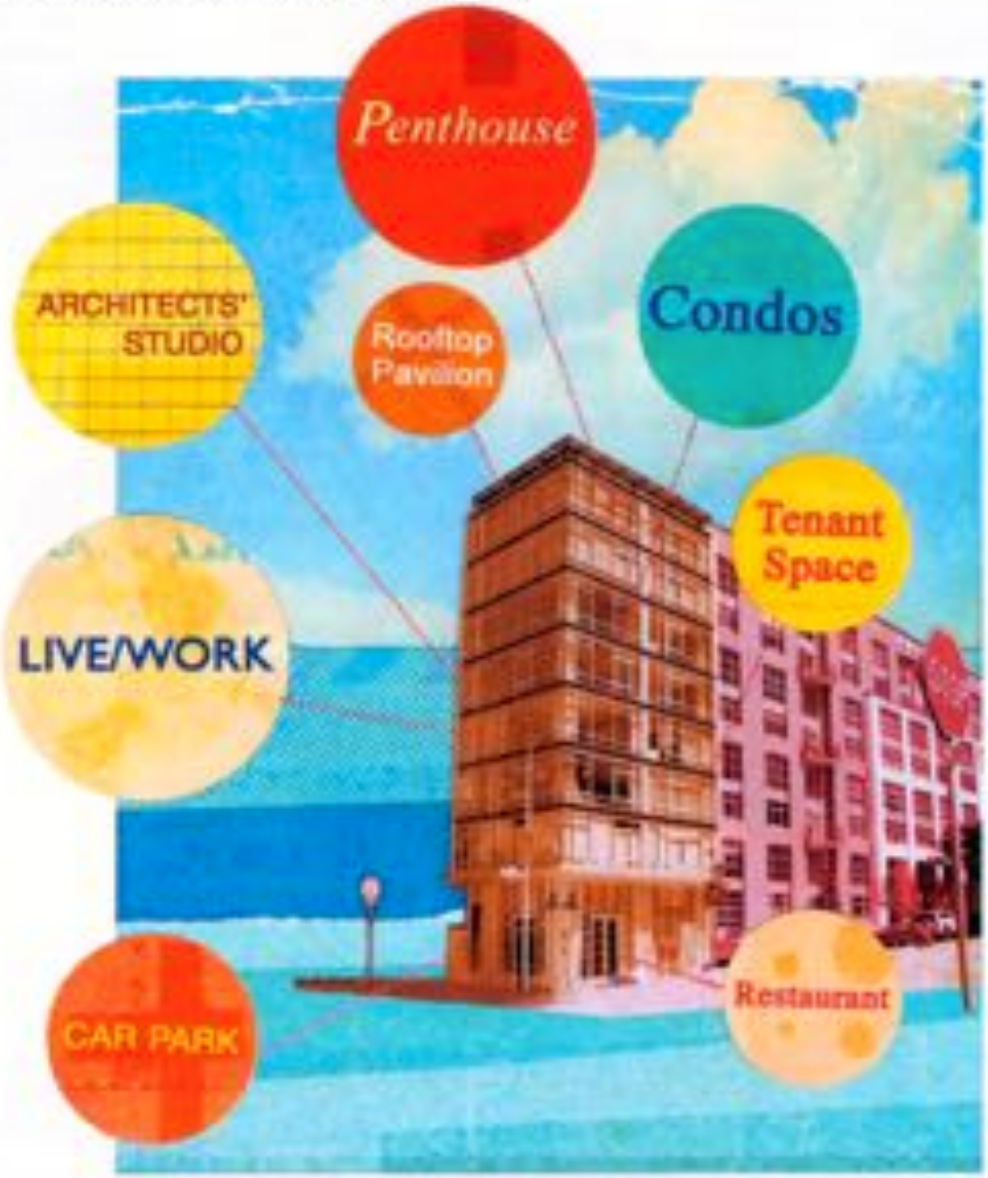
shop talk

savvy architects are investing long-term by owning their buildings.



Martin O'Neill

by cheryl weber

The last decade's blistering real estate performance has rather painfully separated the owners from the renters—the clear winners being those who staked out a property or two on the proverbial boardwalk. As the tide turns, real estate prices are no longer "guaranteed" to go up, and no one knows precisely what lies ahead. But for successful architects with growing practices, owning the space in which they work is almost always a smart business move. It's a way to escape the whims of the rental market while reaping substantial tax benefits. It's a formula for controlling your destiny: Purchase more square footage than you need, lease the surplus, and grow into the extra space as tenant contracts expire. A building that exemplifies your design talent is also great PR—and a sound retirement strategy. Architects often make more money on the sale of their office building than on the sale of their business when they stop working, says Jacklyn Jordan, president and CEO of Capital Access Group, San Francisco.

Coming up with a down payment on commercial headquarters can be tough, however—especially for architects with small- to medium-size practices. Owners of startups struggle to take home a decent salary, and mid-career architects are folding the profits back into their business. The costs may be out of reach for those who work in *exclusive* vacation enclaves too. Just ask Mark Hutker, AIA, who has two offices. One is on Martha's Vineyard, where he owns a spacious suite in a 20,000-square-foot mixed-use waterfront building. The other is in Falmouth, Mass., where he rents prime space in a former restaurant—also on the water—that his firm recently adapted as offices for a local client. "At least three of our clients have come to design meetings in their Hinckley picnic boats," Hutker explains. "We lease the Falmouth office because there's a lot of cachet we wouldn't otherwise be able to afford. The cost to own would be prohibitive."

Like the first commission, the first employee, the first

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partner, buying office space is one of the big milestones. Whether ownership status is the result of serendipitous events or research and calculated risk, it is born out of need, desire, and creativity as architects' fortunes, along with their neighborhoods, begin to change. For Hutker, ownership of the Vineyard office was originally a case of being in the right place at the right time. In 1984, just as the building was being completed, he was invited to form a partnership with the developer, who worked out of one of the condo units. When Hutker spun off the architecture wing of the business a few years later, he purchased that unit, expanding to three adjoining condos over the next 20 years as his bank accounts allowed.

purchasing power

When Taylor Lombardo Architects was scrambling to purchase an office building in San Francisco, it found affordable financing through the U.S. Small Business Administration's CDC/504 loan program. Aimed at healthy, growing companies that are unable to pay cash, the loan allows borrowers to put 10 percent down (compared to the 20 percent or 30 percent required by banks) and charges a flat interest rate —currently about 6.2 percent. The SBA lends up to 40 percent of the project cost and arranges conventional financing for the remaining 50 percent.

"If the purchase is a big stretch because a firm is hoping to grow into a building much bigger than it needs at the moment, we'll stretch out the amortization to 40 years instead of 20," says Jacklyn Jordan, president and CEO of San Francisco-based Capital Access Group, the SBA lender with whom Taylor Lombardo worked. In qualifying businesses, "We look at the personal financial statement," she continues. "Maybe there's nothing left on the bottom line, but maybe the owner is making more than he or she actually needs to live on and can add it back to cash flow." What's more, she adds, the loan "is assumable if someone else acquires the property, and that's a nice thing to be able to advertise if you need to sell." —*c.w.*

long-term leverage

As they look to the future, many savvy architects go the landlord route, choosing a location that will attract good tenants who deliver a steady stream of rental income. When Darrel Rippeteau, AIA, set up his practice in Washington, D.C., in 1978, "if I did have a long-term vision, it was to own real estate," he says. In 1986 he and his wife, Judy, borrowed money to purchase a "crummy little building," a remnant one-story warehouse used to store hot dog-vendor carts at night. After doing basic repairs, Rippeteau Architects moved in, paying rent to the Rippeteaus, who also leased part of the parking lot to a neighbor. It was a gritty block back then. But Rippeteau couldn't help noticing, as he rollerskated to work, that the neighborhood's dangers were "vastly overstated and over-reported." Sure enough, by 2002, real estate values were on the rise and, with the loan paid off, he considered cashing in. But when Whole Foods and other upscale businesses began investing nearby, he decided to use the equity to design a mixed-use building on par with the emerging neighborhood.

In the new iteration, street-level retail space is occupied by gallery plan b, an art gallery for established and emerging local talent. Rippeteau Architects is on the second floor, and a third floor houses two 900-square-foot rental apartments with double-height living spaces and outdoor terraces. "My wife and I got an inflatable mattress and stayed overnight in each one just to get the

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experience," he says. "We would have moved in in a minute. Because we had to borrow money, part of our business plan was that we would sell our house and move in if we had to."

Rippeteau was fairly sure of the commercial component. But with the city's recent condo explosion, he was less certain he could fill the apartments. He tried to capture the discriminating renter by making them theatrical and arty, appealing to people who've made their major investment elsewhere but want to have a foot in D.C. "We've leased to people who are happy to have a stylish, urbane place with their car parked out back," Rippeteau says.

If there's one bit of advice to offer, he says, it's this: be certain about your leasing—as certain as you can be. "When I bought this property initially, I knew that, as a tenant, I could make the rent and pay down the loan. And I knew that when I redeveloped it, the strength of my business would carry this deal," he explains. "I just needed to design something that would attract one or two other tenants. But as an investment strategy, knowing that I was going to build something my architecture firm would pay rent to is a powerful part of why it works for me."

Indeed, as business owners and design-and-construction experts, architects are uniquely positioned to leverage their real estate assets long-term. Through creative financing and some sweat equity, Geoffrey T. Prentiss, AIA, found a spot for his staff of seven in a pricey Seattle neighborhood [see our coverage on page 70 of the January/February 2007 issue]. Prentiss was working out of his home for 12 years and bursting at the seams when he began renting space a few blocks away, in a building owned by a friend. After the owner abandoned plans to redevelop the property in 2003, Prentiss bought it for $485,000. He put $100,000 down, financing the rest with a five-year balloon loan from the owner. The monthly mortgage worked out to be just slightly more than he'd been paying in rent.

But Prentiss didn't stop there. Over the next 18 months, he completed a renovation and 3,000-square-foot addition that comprises, in total, two commercial first-floor units and two apartments above. "It was a good hands-on experience," Prentiss says of the project. "I made sure everyone in the office took responsibility for a section and made it their job to deal with the subcontractors." One commercial unit houses his studio; the other is occupied by an organic coffeehouse on a 10-year lease.

To pay for the $600,000 project, Prentiss refinanced his house, getting an interest rate two points lower than he would have paid on a commercial loan. As planned, his income from the building covers the $10,000 monthly mortgage. "The first year was a little bit of gritting the teeth," he admits. "You still have this big thing leaning against you, and you have to gamble that things are going to stay relatively steady. But this is where architects will get ahead, using the wisdom we've gained in contracting to do something ourselves."

One architect who has done this twice advises architects to plan for more room than they think they'll need. In 1995, John Carney, AIA, principal of Carney Architects in Jackson, Wyo., built a two-story commercial structure with room for a first-floor tenant. But within a few years, his business had grown beyond the dozen or so staff he had anticipated. Carney sold the building and designed another one downtown, on property he bought from a client. His current digs include 4,500 square feet of workspace, plus 1,500 square feet of tenant space. Now that the staff roster has doubled, he plans to take over a 500-square-foot tenant lease that's set to expire shortly. To execute the project, "We created an ownership entity outside the firm, and my kids own a piece of it," he says. "Eventually I'm hoping my partners will too. I think owning a building is about ensuring the ongoing nature of the firm and having this great building that people become vested in."

footing the bill

When you analyze the potential payoff, buying might seem like a no-brainer. But until the dust settles, financing that first building can be frightening. For some, like Maurice Lombardo, AIA, a principal of Taylor Lombardo Architects, getting a foot in the door takes creativity and a high threshold for risk. Lombardo had all but given up on San Francisco's outrageous real estate prices when a broker friend told him about an 11,000-square-foot building on the market for $3.2 million. Its location near the Transamerica Pyramid was perfect, and a restaurant was renting the ground floor. But the three stories above it needed work, and Lombardo couldn't swing the remodel. So instead, the broker suggested a lease-to-own option.

After negotiating a price of $2.775 million, "we put an offer together to lease with an option to purchase in 18 months, using Small Business Administration loans," Lombardo says. That arrangement locked in the purchase price but would have allowed the firm to sell it for a higher (or lower) price when the lease was up, had they failed to qualify for the loan. Meanwhile, he and partner Tom Taylor, AIA, refinanced their homes to pay for a $500,000 remodel of the top two floors—money that counted as a down payment. "It was extremely risky to remodel without owning it, but it was the only way we could do it," Lombardo says. "We moved in on the third floor and had debris falling in our coffee mugs, but we couldn't afford to pay two rents." In November 2004, with the remodel completed, the firm applied for and received an SBA loan (see sidebar). The loan required that it put 10 percent down and occupy 50 percent of the building.

Lombardo says the building's tenant income, including the $10,000 per month his firm pays for use of the third and fourth floors, covers the building's costs. “The rent is about the same as we paid before, but it comes out to be a lot less once you put it all together,” Lombardo explains. “It's a nice way for architects to create a forced savings plan, and it's much better than a 401(k), because you get to use it.”

When it comes to financing, other architects swear by the good will they've garnered with local banks. “We've been giving a local bank here in Omaha, Neb., all of our business—private, commercial, and residential accounts—and that was a really wise move,” says Randy Brown, FAIA, principal of Randy Brown Architects, who also owns Quantum Quality Real Estate, a development firm. “We could sometimes get better rates, and the bank will sometimes finance things before we are 50 percent pre-leased.” In 1999 the development company —Brown plus two partners —went to work on a 10,000-square-foot office building to house the two entities, borrowing 90 percent of its estimated value. “It was a million-dollar investment, plus the cost of the land,” says Brown, who has 14 employees. “We brought the building in at $100 a square foot.”

A $1.2 million retail phase followed in 2002. Brown says the 8,000-square-foot addition was 50 percent pre-leased and 100 percent bank-financed. Four years later, the building achieves a positive cash flow, including the roughly $50,000 a year his architecture firm puts into the pot. It's another example of architects using their design/build expertise to add value as property owners. “I don't see a lot of risk because, at the end of the day, you've built something that can be sold,” he says. “For me, that was the fallback.”

Another cost-efficient option is to buy or build in a redevelopment zone. Vetter Denk Architects is receiving tax credits and low-interest loans to design a commanding commercial building that will house the practice in an up-and-coming part of downtown Milwaukee. After winning an RFP competition, John Vetter, AIA, and partner, Kelly Denk, AIA, created a separate development entity to purchase the $145,000 lot and hired their architecture firm to design a four-story building, valued at $4.5 million. “The city's interest is in creating business opportunities and a tax base, so they're not out to get top dollar,” Vetter says.

Still, the partners spent a year trying to make the project work financially. Originally, they'd hoped to include residential lofts but abandoned those plans in order to qualify for two loan programs geared toward retail commercial. When the building is finished this year, it will include a street-level retail space and three floors of offices, plus a built-out basement and a common-use rooftop pavilion.

port folio power

The flexibility of small firms makes space options even more interesting. In a modern riff on the classic cottage industry, some architects have designed snazzy studios where they live. Christopher Hays, AIA, and Allison Ewing, AIA, LEED AP, the principals of Hays + Ewing Design Studio, Charlottesville, Va., work in a detached studio with their master bedroom above, which connects to the house via a second-story bridge. “We imagined that it would be strategic to have a space we could rent out as a separate unit” or devote to an aging parent, Ewing says. “We usually show people our house as a portfolio project, so the studio has been a good thing. The space shows a quality of life that pictures don't convey.”

In Berkeley, Calif., Sheahan + Quandt Architects principals Patrick Sheahan and Cathleen Quandt teamed with two other professionals to develop a rare sliver of land that's zoned as residential/commercial. They paid cash for the land, and each used a third of the equity to create live/work spaces for themselves [see our coverage on page 104 of the January/February 2007 issue]. The couple can write off depreciation on the 40 percent of the building they use for business, and lowering their personal taxes frees up money to pay down the loan. “When it's an investment in both your business and your personal life, there's a different financial dynamic,” Sheahan says. “Everything is at stake, but you have everything to gain.”