Selling a business that owns its building

When the business owner also owns the building, there are two sales to plan. The decision about the building is easier to make before buyers are involved than after.

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Many owners think of the building as part of the business. They bought it years ago, the business has paid for it one way or another, and when they picture a sale they picture handing over the keys to both. In Greater Cincinnati that's a common setup for trades contractors, distributors and light manufacturers, often with the building held in a separate LLC.

Buyers and lenders see two assets with two prices. The owner usually has three choices. Sell the building with the business, keep it and lease it to the buyer, or sell it separately. Each one changes the price, how the buyer pays and what the owner holds after closing, so the decision belongs in the preparation stage described in The five stages of a business exit, well before a buyer makes an offer.

The building and the business are valued differently.

A Main Street business is priced as a multiple of what it earns, usually a low single-digit multiple at this size. A commercial building is priced on its rent, through a cap rate, the return an investor expects from the property. An SBA lender sets the business price with the building's appraised value taken out, and a careful buyer does the same.

Rent connects the two. If the business pays its owner below-market rent, or none, its earnings look better than a buyer will experience them, because the buyer will pay market rent after closing and will price the business with that rent in the expenses.

Why selling the building separately can be worth more.

A dollar of rent is worth far more in a building sale than a dollar of earnings is worth in a business sale. Cap rates turn rent into value at a much higher multiple than the earnings multiples small businesses sell for, so a building priced on its own usually brings more than the same building folded into the business price. UHY Corporate Finance makes the same point about mid-sized companies, where the gap is smaller than it is for Main Street businesses.

Here's an example with round numbers. A building that would rent for $80,000 a year, in a market where similar buildings sell at an 8 percent cap rate, is worth about $1 million on its own. Folded into a business priced at three times earnings, that same $80,000 adds about $240,000.

The gap only matters if the building would otherwise be priced inside the business. It also depends on the lease. A building leased to a small business sells at a higher cap rate, so a lower price, than one leased to a national company, and the rent is only as reliable as the new owner running the business.

Selling the building with the business.

One sale gives the owner a single closing and no landlord role afterward. It can also help the buyer's financing. Under SBA rules the business portion of a loan can run no longer than ten years, while the real estate portion can run up to 25, which lowers the monthly payment on the combined deal and may help a buyer meet the lender's coverage test. The trade-off is a larger purchase for the buyer to finance and fewer buyers who want both. A buyer using SBA money for an existing building must also occupy at least 51 percent of it.

Keeping the building and leasing it to the buyer.

Some owners keep the property for income after the sale, which means the buyer needs less money at closing and the owner collects rent instead of a lump sum. The owner's former business becomes the tenant, so the rent depends on how the new owner runs it.

The lease carries much of the risk and the value. On an SBA-financed purchase, the buyer's lender will usually want the lease, including renewal options the buyer controls, to run at least as long as the loan, which on a business purchase is typically ten years. Some buyers ask for a purchase option at the end of a shorter term so they can operate in the building before committing to it.

Selling the building separately.

Selling the building to an investor, with the business as the tenant under a new lease, is called a sale-leaseback. It can come before the business sale or alongside it, and it puts the building in front of buyers who price real estate. It makes most sense when the building is worth more to an investor than to a business buyer, or when the owner wants the two sales on different timelines.

How the buyer's financing fits in.

Most Main Street transactions depend on financing, often an SBA loan, a seller note or both. The SBA's 7(a) program can finance a business purchase and its building together, and its 504 program is built for buildings and equipment. More on how buyers finance small industrial and flex buildings is on Cincinnati Small Bay.

What owners often miss

The building decision changes the business price. An owner who has charged the business little or no rent will see earnings drop once market rent goes in, and owners who find that out from a buyer's diligence team are negotiating from behind.

Keeping the building also means staying tied to the business. If the new owner struggles or moves, the former owner is holding a building that may sit empty while it's re-leased or sold.

Decide before buyers are involved.

A building and a business are taxed differently when sold, and how the price is split between them is a decision to make with your CPA and attorney before a letter of intent. As What you need to step away covers, what matters is what you keep after taxes and costs. Working through the building question early is part of exit readiness, and it leaves room to set market rent, get an independent opinion of the building's value, and choose the path before the first conversation with a buyer.

Common questions

Should I sell my building with my business?

It depends on whether you want income from the property after the sale, what the building is worth to other buyers, and how the buyer plans to pay. Selling both gives one closing and no landlord role afterward. Keeping the building and leasing it to the buyer lowers what the buyer has to finance. Make the decision before going to market, with your CPA and attorney.

Can a buyer use an SBA loan to buy the building too?

Yes. An SBA 7(a) loan can finance the business and the building together, and the real estate portion can be repaid over a longer term than the business portion. To use SBA money for an existing building, the buyer's business generally has to occupy at least 51 percent of it. If the buyer leases instead, the lender will usually want the lease, including renewal options the buyer controls, to run at least as long as the loan.

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A Confidential Exit Readiness Assessment is a private first conversation about where your business sits in the process, what buyers are likely to care about, and what a prepared path forward may look like. Preparation does not obligate you to go to market.

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