



Property Ownership vs. Leasing

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Should a company own its facility or lease it? That is a question that should be asked by any firm that will need to occupy space. While there are a few instances in which leasing is the logical choice, whenever possible, ownership generally proves to be a better alternative.

There are two general ways of looking at occupancy. The first is the simple "right to use" the location. A tenant has the right to use the property they lease from a landlord. The only profit they gain is from their business operation. The second is the "right to grow" with the location. In addition to the business income, they reap the increase in value and other tax benefits.

When a company leases a property they are essentially paying for the investor's long-term profits. Even in a depressed real estate market, rents almost always cover the expenses of ownership. In fact, while a mortgage generally remains the same throughout the term of a loan, rents almost always increase on a regular basis.

Example: Let's say a company needs 13,300 square feet of space to operate its business. Further, assume that buildings sell for \$75 per square foot. The property would be worth approximately \$1,000,000. If the loan is 75% of the value, and the interest rate is 6.5% for 25 years, the monthly loan payment would be \$5,060, or just about \$0.39 per square foot. A tenant would be hard pressed to find a building that would lease for that rate in most markets. Further, if the rent increases 5% every 30 months, they will be paying \$0.47 per square foot by year ten rather than \$0.39 if they own the property.

Over the long-term, real estate values appreciate, or, go up. While there are relatively short periods of declining prices, each decade has shown an overall increase in value. As an owner, a company gets the benefit of the increase in value.

Example: If we assume that a property costs \$1,000,000 and a buyer puts down 25%, their initial investment is \$250,000. If the average increase in a property's value is just 5% per year, in ten years the \$250,000 equity investment will have increased to over \$875,000! That is a 350% return on the equity invested.

An owner of a property has greater control over the improvements. A tenants isn't very motivated to improve the property, even if the changes might enhance the functionality of the facility for the company's use. An owner will be motivated to improve the property to increase the facility's functionality, which can improve business profits, and the investment will increase the property's value. As an owner, there is a long-term return on money invested in the property.

Historically many corporations concerned with public reporting have chosen to lease in order to avoid having depreciation negatively impact their financial performance. However, in 2013 the reporting standards should change to cause all tenants to recognize depreciation and amortization on their cash flow statements. This only increases the reasons to own rather than lease, and we should anticipate fewer companies leasing, and more investing as building owners.

There are a few logical reasons for leasing rather than owning. The first is the inability to raise the funds required for a down payment. This is partially alleviated by the availability of high-leverage loans through SBA (Small Business Administration) which can reach 90% of the property's value. The second is the return that can be earned in the business as opposed to the real estate. However, if a company is operating a strong business, the funds to invest in a facility should be available, and it would seem foolish to pass up the real estate profit. The third is the need to occupy space that needs to be part of a larger complex, such as some retail locations.

In summary, as a rule companies should take advantage of the flat monthly payment over a long period, the incredible increase in value and the control of the property.