REAL ESTATE STRATEGIES CORPORATION
www.realstrat.com

To Own or Lease: That is the Question!

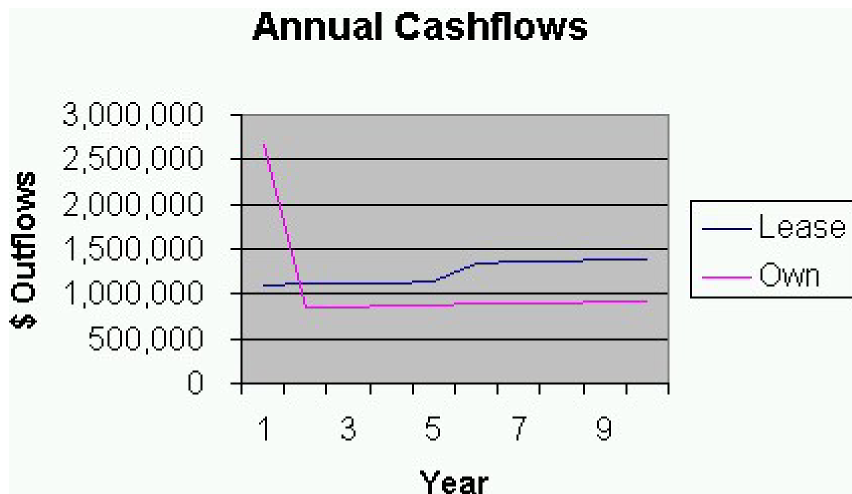
Whether a company owns or leases space, it can expect to spend approximately the same amount of money to occupy real estate over a six (6) year period. Throughout ownership, any appreciation in value accrues to the owner, and after the six-year mark, the positive cash flow differential of ownership over leasing becomes greater and greater.

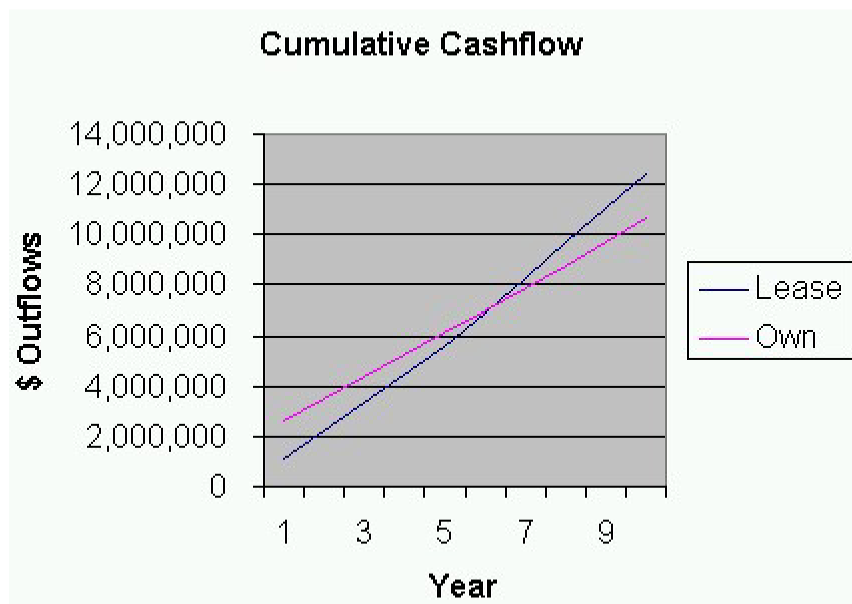
Still, leasing real estate has advantages for many companies and ownership isn't always the right solution. When making leasing vs. ownership decisions, your management team must consider your company's:

- Growth rate (positive or negative)
- Borrowing capacity
- Ownership structure, (public or private)
- Required real estate investment costs
- Capital required for non-real estate business initiatives
- Risk tolerance
- Security concerns
- Tax profile
- Mission critical space requirements
- Building management
- Numerous other criteria

This article focuses on cash flow and leaves the other, equally important, criteria for future discussions.

At the risk of oversimplification, a 50,000 square foot building, located in a market where a lease would command an average ten year rental rate of $24.00 per square foot gross plus utilities (beginning at $22.00, and increasing to $26.00 at the beginning of year 6) might sell for between $5 and $10 million, depending on a number of moving parts. For our analysis, we assumed a purchase price of $7.1 million and a twenty-five percent down payment. Illustrations (below) of annual and cumulative cash flows demonstrate the cash flow trade offs that exist between owning real estate and entering into a lease arrangement. This comparison of cash flows is not to suggest that ownership or leasing is inherently superior to the other. Rather, it represents anticipated cash flows. Which option is best for a particular company depends entirely on the company's desired cash flow profile, its other uses for cash, its long and short term business plans, its borrowing capacity, and more. Additionally, this same analysis can be conducted on post-tax and on discounted post-tax basis in order to tailor an own vs. lease comparison to a company's precise situation.





From a cash flow perspective, key drivers for making an investment in real estate are a company's liquidity for making the down payment and paying closing costs, capital costs for interiors and improvements, alternatives for investing cash in other investments or other areas of the company's business, available financing rates and terms, a company's borrowing capacity, assumptions about appreciation in the value of the real estate, and the internal rate of return required by a company of its investments. It's entirely conceivable that the six (6) year break even point cited earlier can be accelerated to an earlier year if the value of owned real estate appreciates and the property is refinanced to redirect the initial investment in ownership out of a particular building and into other areas of your business. On the other

hand, should a property require considerable improvement during the term of ownership, the six (6) year break even point could be delayed, as well.

Obviously, being able to occupy real estate more cheaply in future years is the reward for making a first year investment in an ownership position. Regrettably, a number of “rule of thumb” guidelines and “gut” reactions to ownership versus leasing are often employed to make decisions as critical as this. Your company’s strategic business objectives can only be served through your real estate decisions, if alternatives to your current situation are periodically explored in the context of detailed pre- and post-tax cash flow analysis. Furthermore, such alternatives must be viewed relative to other decision criteria, as mentioned above.

What’s the answer? Well, that depends on what your company does, how it does it, why it does it, where and when it does it. Some of our privately held clients prefer to own their real estate for the tax and appreciation benefits they derive. Others deem certain of their operations to be strategic in nature and, therefore prefer to own because they make significant capital investments in equipment and do not wish to be subject to changes in leasing market conditions. On the other hand, many of our clients prefer to retain their capital for investment in their companies, and enjoy the flexibility of leasing that comes along with not needing to manage property. There is no one single right answer to owning versus leasing. The answer depends on your company’s who, what, why, where, and when.

Real Estate Strategies Corporation, located in Kenilworth, New Jersey, and serving clients throughout the country, helps companies create and execute Business *DRIVEN* Real Estate Solutions...and Opportunities, faster and with less risk. Visit www.realstrat.com.

Read other business, real estate, and finance articles written by RealStrat's experts.

Licensor: Real Estate Strategies Corporation. Copyright © 2004-2007 by Andrew B. Zezas. All rights reserved.

THIS WORK IS DESIGNED TO PROVIDE PRACTICAL AND USEFUL INFORMATION ON THE SUBJECT MATTER COVERED. HOWEVER, IT IS SOLD AND/OR PROVIDED WITH THE UNDERSTANDING THAT THE AUTHOR AND THE PUBLISHER ARE NOT ENGAGED IN RENDERING LEGAL, FINANCIAL, ACCOUNTING OR OTHER PROFESSIONAL ADVICE TO THE READER. IF LEGAL, FINANCIAL, ACCOUNTING OR OTHER PROFESSIONAL ADVICE IS REQUIRED, THE SERVICES OF A COMPETENT PROFESSIONAL SHOULD BE SOUGHT. THE AUTHOR AND THE PUBLISHER SPECIFICALLY AND EXPRESSLY DISCLAIM ANY LIABILITY THAT MAY BE INCURRED AS A RESULT OF THE USE OR APPLICATION OF THE INFORMATION THAT IS CONTAINED IN THIS WORK.