

Buying vs. Leasing: It's Not Just About Real Estate

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The decision to buy or lease the facility in which a firm conducts its business is of major financial consequence to the firm. Objective, accurate information must be provided to the firm so they may make the decision that best suits the company's strategic goals.

You can always expect more from SIORs—they are “the best of the best,” when it comes to providing excellence in real estate services and creativity in executing transactions. As commercial real estate professionals, they have been providing real estate services to clients and customers for many years, and have probably helped many companies make that all-important decision: To buy or to lease? The decision not

only involves the pros, cons, and financial implications of buying vs. leasing commercial real estate. There is more to this topic than the obvious.

How do executives really make the decision to buy or lease? Is the decision to buy or lease made solely on the financial merits of real estate alternatives? Are there external forces in effect that can influence the real estate decisions that executives make?

Is the issue of buying or leasing simply a real estate decision or one having a far greater impact on your client's overall business?

Evaluate Your Client's Overall Business Needs

To guide your client into making the best business choices, you must gain a true understanding of his or her overall business needs. Major decisions are not made in a vacuum. Likewise, buying vs. leasing commercial real estate is not a consideration that should be based solely on the financial considerations. Many internal and external factors affect such decisions and their eventual outcomes. As a knowledgeable real estate expert and businessperson, you are armed with essential data that executives need to make the choices that will best support their overall business needs. If you, as a trusted advisor, focus purely on the economics of your client's real estate needs, you could jeopardize the accuracy of the ultimate decision. On the other hand, if you help your client focus on how non-real-estate—related forces will affect the successful outcome of his or her ultimate decision, you increase the likelihood that the eventual decision will be the right one. You will be better able to protect your client's interests, as well as your long-term relationship with that client.

As your client's representative and advisor, your job is to help that client make the best business choices, not just the best real estate choices. How many times have you seen companies make great real estate deals (long-term

Benefits and Risks—of Leasing, of Ownership

Some Benefits of Leasing:

- Easy means to occupy real estate, often with lower up-front capital requirements.
- Ease of disposition at end-of-term.
- Ability to select a length of lease term, within reason, to support operational requirements.
- Flexibility of growth, contraction, long or short term, etc.

Some Risks of Leasing:

- Fluctuations in market pricing and landlord-provided allowances, incentives, etc.
- Potential for loss opportunities, associated missed options, and notice dates.
- Disposition prior to end-of-term can be challenging, depending on supply and demand, and on other factors.
- Most often dependent on third-party management for quality of life and service issues.

Some Benefits of Ownership:

- There comes a point in time after which, with continued occupancy, ownership becomes less expensive each year on a cash basis.
- Depreciation (may not be beneficial to publicly held companies).
- Income tax benefits.
- Capital appreciation.

Some Risks of Ownership:

- Ownership of real estate is a separate business that requires attention.
- Potential loss of value.
- Interest rate and economic risk.
- Neighborhood, transportation, and demographic risks.
- Less flexibility than leasing.

transactions, low rents, large concessions, below-market sale price, etc.), only to find out later that their choice negatively affected their business?

The traditional “make a deal” broker sees his or her role as that of a real estate specialist, skilled in market knowledge and

negotiating expertise, whose job is to focus on a client's real estate deal and the financial components of the transaction. But the professional advisor understands that real estate is merely a catalyst for his or her clients to achieve success in core areas of their businesses.

Nine questions to help you better understand your client's business (and real estate) needs:

1. Does your client's business plan require them to maintain operational control of the property for a long time? Why? If so, can your client achieve sufficient control of the property without buying?
2. Would a long-term lease provide sufficient long-term operational control of the property?
3. Would a traditional five- or 10-year lease with successive renewal options satisfy your client's needs?
4. Will your client invest large amounts of capital into infrastructure or equipment specific to his/her business?
5. What other areas of your client's business demand cash (daily operations, investments in other companies, securities, etc.)?
6. What hurdles must your client overcome before being positioned to make a decision to buy real estate?
7. How much risk can your client accept to achieve maximum ROI? What constitutes reasonable risk for your client?
8. Can your client secure financing at rates and on terms that would make buying beneficial?
9. Is your client's business relatively stable? Do they project significant changes in headcount, customer base, revenue, profit, or the competition over the next five to 15 years? Do they require flexibility and the ability to grow and shrink with changes in their business?

Decision Drivers

- Up-front cash requirements
- Internal competition for capital
- ROI requirements
- Short- vs. long-term plans (impacted by technological, manufacturing, or other large capital investment plans)
- Expectation of rapid or sudden change in business, headcount, revenue, product/service demand
- Economic predictions/concerns
- Projected market conditions
- Demographic and labor force changes, and socio- and geo-political issues such as employee off-shoring
- Neighborhood stability
- Capital appreciation
- Financial reporting
- Income tax implications
- Perceptions that companies that own real estate are more stable, conservative, better funded, long-term focused, etc.

Which is the most important driver to your clients? Most likely, a combination of many of the above drivers will affect how your clients make decisions.

To use an analogy, consider the computer on your desk. Each day you arrive at work, turn on your computer, read and respond to some of the 300 e-mails you received the night before, create spreadsheets, conduct research, etc. But, none of that constitutes your core business. They are all in the periphery of your primary objective. Unless your name is Michael Dell, the computer on your desk is not what you do; it is only the tool that helps you get your job done. Similarly, your client occupies real estate as a means to an end, not because real estate is his or her main focus. In this respect, most companies are in the real estate business by default, and they don't even realize it.

For your clients, the buy vs. lease decision probably has many drivers—a combination of many financial and operational factors based less on the real estate itself and more on business needs and expectations.

The key to your success in supporting your clients' decision-making abilities is to step back and focus as much on the business requirements and objectives as you do on the actual real estate alternatives. Only then can you fashion solutions that best support your clients' objectives. After that, the decision whether your clients should buy or lease properties will be a lot easier for them, and for you. Your relationship with your clients will then evolve from one where you are solely a service provider to one where you become a trusted business advisor—someone upon whom your clients will rely for more than just their next real estate transaction.