OWNING VS. LEASING COMMERCIAL REAL ESTATE

I frequently meet new clients who are intent on purchasing their business premises under the old adage “I am better off putting money in my own pocket than someone else’s.” Owning commercial real estate where you are your own tenant can be extremely rewarding and act as an excellent retirement savings/wealth generator for a business operator. However, there are many factors to consider as a business in determining whether purchasing commercial real estate is both feasible or even a prudent decision at all. Here are some considerations for both avenues:

OWNING:

- It is important to understand your medium and long term space requirements. Stability in size is important. New, growing or economically sensitive businesses that have an unknown future size or can contract and expand quickly based on business conditions should be cautious to commit to ownership.
- Ownership can frequently cost less on a month to month basis in particular over time when the payments drop with higher equity in the property. However, purchasing commercial real estate requires a large down payment of 25-35% of purchase price. There is also an opportunity cost to tieing up that down payment in the real estate, meaning that you may be able to better leverage that capital in the execution of your business as opposed to the real estate asset.
- Owning your property can be excellent on your company’s balance sheet to increase access to working capital and more favorable loan arrangements.
- Stable revenue is a must to commit to a long term mortgage to ensure that operations are not hindered by the monthly commitments in tougher time periods.
- Owing your space can allow for additional investment to project corporate identity to clients/customers that would be injustifiable is a lease space
- Ownership can provide operational stability in avoiding market rent increases or untimely evictions. There is additional risk in being responsible for maintaining and upgrading the asset that would normally be the burden of a landlord.
- Although there can be long term rewards in real estate appreciation, user specific assets are not particularly liquid and could be difficult to liquidate in tougher times.

RENTING:

- Renting can be significantly more attractive to new, growing or economically sensitive businesses because with the exception of security deposit and any required tenant improvements you are only required to make your monthly rent payments.
- Purchases require a large down payment, loan fees, closing costs and ongoing maintenance costs, frequently unplanned
- In many cases a tenant can take advantage of move-in ready space where another tenant or the landlord previously made the investment required to set up the space

- In many cases a landlord will assist with tenant improvements or start up costs to secure a tenant
- As a tenant you are much more nimble and versatile in responding to changes to your business and the real estate market. In a real estate downturn you can negotiate more favorable lease terms in making a move and take advantage of that softness in the market.
- A tenant can deploy additional working capital to a more strategically desirable location and pay higher rent (with returns!) if their capital is not tied up in a real estate asset.
- Monthly lease payments frequently have higher tax deductibility than ownership costs.
- One of the large drawbacks of leasing space is you are at the mercy of rising real estate markets and the landlord's prerogatives:
    - If your lease is not properly structured you could run into unreasonable rental increases after you have invested in the landlord's space
    - If the market rent in a neighborhood is rising you may need to make an untimely move
    - If a building sells you could run into problems with your entitlements to your space or demolition of a redevelopment space
    - A landlord who doesn't take good care of a building could be difficult/costly to motivate to make necessary repairs & negatively impact your business
- Leasing does not create any long term wealth, the money is gone.

In general terms purchasing commercial real estate is best reserved for those with some predictability and stability in their business operations and financing, leasing better aligned with newer, growing or economically sensitive businesses. There are very business specific considerations that will impact this decision such as unique facility and equipment requirements and strategic locations. In addition to a commercial broker's advice it is wise to receive professional accounting and legal advice prior to entering into more substantial lease or purchase commitments.