



LEASE vs BUY vs SALE LEASEBACK



MIKE DONNELLY
530-828-0011
mike@californianorthern.com
License # 01429436

Lease vs. Buy vs. Sale Leaseback

Lease

Benefits

- No worry of selling if you are moving to a new location
- Monthly rent is a tax deduction as a business expense (Subject to the term and accounting guidelines)
- Flexibility to sublet or move if needed at the expiration of the lease
- No loss if owning in a bad market
- Less cash investment up front
- More cash for expansion
- Know what expenses will be as stated in the lease

Disadvantages

- Rental rates with annual escalations based on market conditions
- Loss of the reversion or the value of any remaining capital investment at lease end
- No equity buildup or appreciation value of property
- May be forced to move at the end of the lease
- Contractual Penalties
- Subject to Landlord / Property Manager's operational control

Buy

Benefits

- Interest on the mortgage loan is tax deductible
- You know what the fixed operating cost are going to be based on your specific site needs
- Changes can be made to the building to accommodate your specific business
- You can take annual depreciation deductions on taxes
- No annual rent increases
- You can benefit if you sell when it is a strong market and your property has appreciated
- Earn income by leasing excess space
- No restrictions on hours of business operation
- The location of your business remains constant
- You can take a line of credit on your loan to make improvements

Disadvantages

- Usually requires more initial capital to secure financing
- Property values may decline
- Subjects the owner to various legal, safety and regulatory risks not associated with leasing (must purchase insurance)
- Requires owners to invest time, energy and funding in managing the property, which is typically not a core aspect of your operation, unless a Property Manager is hired
- Inexperienced owners may operate their real estate inefficiently and increase operating costs
- Increase in property taxes, management costs and upkeep
- Adjustable Loans

Sale Leaseback

Benefits

- Continued use of the familiar property during the lease term
- Removes a capital asset from the balance sheet at book value and replaces it with cash realized from the sale
- Free up cash for other investments
- Help reduce business income tax liability caused by the appreciation in value (land only) of its corporate real estate assets
- Monthly rent is a tax deduction as a business expense (Subject to the term and accounting guidelines)
- Flexibility to sublet or move if needed at the expiration of the lease
- Can usually structure the initial lease term
- Provides new owner with long-term tenant, making it an appealing property to be purchased

Disadvantages

- If the rental market softens, may be locked into the higher rental rate negotiated at the time of the sale-leaseback
- Loss of the reversion or the value of any remaining capital investment at lease end
- Loss of future appreciation of property value
- May be forced to move at the end of the lease if no renewal options are built in
- Contractual Penalties
- Now subject to Landlord / Property Manager's operational control
- Lose the flexibility associated with property ownership, such as changing or discontinuing the use of the property or modifying a building
- Tax impact may be substantial if the property has been owned for a lengthy period and/or the book value is low compared to the selling value
- Loss of potential sub-let income

Lease vs. Buy vs. Sale Leaseback

Today's current economic climate poses a unique situation for organizations who are in the market looking for space. Taking in to account rental rates and the current sales market as well as the dilemma of deciding whether to lease or buy real estate facilities is a question often encountered by many companies. What are the advantages and disadvantages of each? While every business is different, there are a few common factors that should be taken into consideration when evaluating whether to buy or lease office space.

1. **Opportunity Cost** – With the large outlay of capital required to purchase office space, the opportunity cost of that the capital and alternative uses needs to be factored. If the funds are to be used for a purchase, has the organization decided on an acceptable rate of return or safe rate for their investment and what they expect to receive on that money compared to the return they would expect to receive if they invested the money back into your business or into other investments?
2. **Growth Considerations** – The growth phase of the business should be a major consideration in making the lease vs. buy decision. If your company is relatively new and/or in a high growth mode, leasing can provide more flexibility and fewer constraints to that growth. On the other hand, if your company is mature and stable or you have a significant specialty use that could adversely affect your lease tenancy, then buying office space is great alternative to meet your future office space needs.
3. **Long Term Business Plan** - The strategy should match the long term business plan of the company; these types of decisions require long term planning.

But before any decision is made, do your homework; know the pros and cons of both buying, leasing or sale leaseback. The enclosed page discusses the benefits and disadvantages of each scenario.

The Bottom Line

When considering whether to lease, buy, or sale leaseback, it is critical to have an understanding of all complete financial implications for your company. Analyze every element of the situation: programmatic space needs in your current environment and five and ten years out, cash flow, future projected expenses, expectations for rental increases and property value appreciation, interest rates, and management costs. You'll gain the best understanding by breaking things down three times, based on the best outcome, the expected outcome and the worst outcome. Don't just think of your business as how it operates today; consider where your business is going. It seems like a daunting task, but Coldwell Banker Commercial® professionals have the knowledge and experience to assist with these decisions.

© 2009 Coldwell Banker Commercial Affiliates. A Realty Company. All Rights Reserved. Coldwell Banker Commercial Affiliates fully supports the principles of the Equal Opportunity Act. Each Office is Independently Owned and Operated. Coldwell Banker Commercial and the Coldwell Banker Commercial Logo are registered service marks licensed to Coldwell Banker Commercial Affiliates.

Speak with a Coldwell Banker Commercial professional about leasing or purchasing a commercial property to see which method is the proper investment option for your company.

