Business Owners: Time to own instead of rent?

By Beth Jo Zeitzer

As our market is recovering, with historically low pricing and interest rates, many business owners ask themselves whether it is better to own their own building instead of leasing.

From a pricing perspective, in 2008 owner-occupied office, industrial and retail product averaged $252 per square foot.[1] Pricing steadily declined, and the average owner-occupied building is now $125/sq. ft. in Q3 2013,[1] with plenty of opportunities below this price range as well. This current pricing is discounted 50% from 2008. Interestingly, current average lease rates are only 30% less than 2008 averages.

The economics of owning versus buying should always be at the forefront of this decision, along with several other factors including cash outlay, fixed costs, growth considerations, control and management of the property, investment potential through other tenants, potential appreciation and tax factors.

Cash Outlay: If you purchase a building, you typically can expect to make a down payment of between 10 and 25% depending on the lender and your credit. There are numerous options for Small Business Administration loans as well as conventional loans these days. SBA loans require as little as 10% down. With historically low interest rates, a business owner/building owner generally ends up paying less in monthly payment/maintenance costs versus leasing a facility.

Fixed vs. Variable Cost: Property owners with fixed-rate mortgages and a good understanding of their management costs have a solid understanding of their long-term costs. Tenants are susceptible to market fluctuations when their lease term expires.

Control of the Property: Property owners have control over decision-making for additions and/or renovations. This includes operating factors, as well, including hours of operation and other essential decisions related to the needs of the business owner's customer base.

Additional Income: Businesses with long-term growth plans may consider buying buildings with income stream potential through third-party tenant leasing. Buying a larger property than what the business needs at this time allows a business owner/building owner to capitalize on future growth considerations by subsidizing current vacant space with tenants, gaining lease income in the interim.

Tax Factors: Property owners can capitalize on additional tax benefits including deducting loan interest, property taxes and other qualifying expenses. Additional tax strategies may be considered, including forming an LLC to act as property owner and leasing space to the operating business.

Appreciation: One of the primary goals of buying a building is to generate a long-term increase in value through market appreciation. Tenants do not see the benefit of appreciation, as their monthly rent expenditure does not go toward ownership/building equity.

The chart at left shows an own versus lease scenario: This example assumes the acquisition of a 5,000-sq.-ft. building at $80/sq. ft., 10% down payment and an SBA loan amortized over 20 years at 4.5%. This is compared to the lease of a building of the same size at $15/sq. ft., full service.

The monthly effective cost, if purchased, is approximately $3,000, versus a $6,000 effective cost if leased. Under this scenario, a property owner could save 43% in monthly cost by owning his or her office/facility versus leasing. In addition, a building owner has the extra added benefit of building equity (29% in equity, assuming an annual appreciation of 3% per year).

[1]Co-Star Data

Beth Jo Zeitzer is the owner and designated broker of R.O.I. Properties, a full-service real estate brokerage firm focused on working with business owners, investors and property owners regarding the management, marketing and sale of commercial and residential properties, including office, industrial, retail, multi-family, hospitality and land assets. She can be reached at 602-319-1326 or bjz@roiproperties.com.

PURCHASE ASSUMPTIONS:		
Project Cost		$400,000
START-UP COSTS		
Cash down payment (10.00%)		$40,502
(includes financed fees)		
MONTHLY COSTS	Per Sq. Ft.	Amount
Mortgage payment	$0.54	$2,693
Operating costs	0.42	2,083
Association Dues	0.00	0
Total Monthly Costs	0.96	4,776
MONTHLY OWNERSHIP BENEFITS		
Monthy Depreciation estimate (1)		684
Tenant income		0
Monthly appreciation estimate: (3.00% annualized)		1,000
Total Ownership Benefits		1,684
TOTAL EFFECTIVE MONTHLY COST		**$3,092**

LEASE ASSUMPTIONS:		
Rent per square foot per month		$1.25
Rent per month		$6,250
START-UP COSTS		
Prepaid rent and security deposit		$12,500
(Equal to 2 months rent)		
MONTHLY COSTS	Per Sq. Ft.	Amount
Rent payment	$1.25	$6,250
Operating costs	0.00	$0
Association Dues	0.00	0
Total Monthly Costs	$1.25	$6,250
MONTHLY OWNERSHIP BENEFITS		
Monthly depreciation estimate:		N/A
Tenant income		N/A
Monthly appreciation estimate:		N/A
Total Ownership Benefits		N/A
TOTAL EFFECTIVE MONTHLY COST		**$6,250**

• Property Value and Owner's Equity (2) •

Time Period	Property Value	Loan Balance	EQUITY
Year 5	$463,710	$310,704	**$153,006**
Year 10	$537,567	$229,726	**$307,841**
Year 15	$623,187	$126,012	**$497,175**
Year 20	$722,444	($0)	**$722,444**

(1) Depreciation is estimated based upon 80.0% allocation of purchase price to building cost that is depreciated over 39 years.

(2) Owner's equity calculation assumes annual appreciation rate of 3.00% and a constant interest rate as outlined above. Rate may be subject to change.

· The above figures are for discussion purposes only and are subject to change. This is not an offer or commitment to lend. All credit decisions are subject to credit qualification

Prepared for: Beth Jo Zeitler

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