# Buying vs. Leasing Your Building

There comes a time in the life cycle of a business when the business owner confronts the question: should I continue to lease or is it time to buy? This is an interesting question because it encompasses many aspects of business: interest rates, growth potential, financial stability and even depth of management (more on that later). While the owner may think the decision is simply comparing the rent to mortgage payments, the analysis is more complex. Like any tough decision it's good to start with a list of pros and cons.

First the pros; buildings are a great way to build equity. While businesses are difficult to sell, actually most do not transfer outside the family, buildings are relatively easy to sell. Based on market comparables, the fair market value of a building is relatively easy to establish and there is usually a market for a building. A business, on the other hand, may be so specialized and so uniquely connected to the personality of its owner/operator that it will never have a significant market. Interestingly, owning a building can help sell a business. A buyer can access the equity in the building, through refinancing, to facilitate a sizable down payment on both the building and the business, thus removing what is often the most significant obstacle to putting a deal together.

Often times having a bigger space in which to operate gives the business owner the vision to expand operations. I cannot tell you how often I've seen business owners afraid to expand because they don't want to sign a lease for more space, or subject their employees to cramped

quarters, which, of course is the tail wagging the dog. However, it is important to note more space does not automatically mean more business. A good rule of thumb to consider before buying a building is making certain your business should has a vision as long as the mortgage. For example if your building has a 20 year mortgage your business should have a matching 20 year vision. You might say I don't even have an idea for lunch today let alone a 20 year vision for my business, if so, that might be a good reason to continue to rent. Thirty years ago, a very astute client of mine, who was a real estate investor, told me that real estate is the stupid man's investment because it eventually pays for itself and usually appreciates. He looked me in the eye and said, "Pat, invest in real estate, you take care of it and it takes care of you." This worked out in spades for him and it does for most real estate investors. However current market conditions would indicate that these truisms aren't as true as they once were, so before buying a building, it's critical to have a long term business plan to ensure your building fits your plan.

When you think of McDonald's you probably think of hamburgers first and then the golden arches. What does this mental association indicate? A building can be part of a brand. This is not just true of fast food chains but service businesses as well. For example I have a client who owned a dental practice, who was able to receive premium when he sold his practice because it had been located in the same first class building for a long period of time and as the owner stated "the patients just automatically come here when they want to see a dentist no matter who it is." I believe this is true for many service businesses. We all know that certain building that's been a restaurant forever but has gone through multiple owners, each having success.

When you build your own building you get exactly what you want. When you lease you are always left with some spot you can't use or you have to jury-rig to make current operations fit. None of this is true when you build exactly what you want. Clearly, if you're operating a manufacturing facility efficient space means lower costs and more profits. These efficiencies often help to quickly offset the additional costs of owning versus leasing.

Over the course of 30 years in business I've never had a client that was sorry they bought the building in which they operate their business. Many owners see their building as a significant augmentation to their qualified retirement plan. However, unlike such a plan, the building is usually for the owner's benefit only. This is especially true if the building will be paid off by the time the owner retires. Now if you ask business owners about other real estate investments they've made, particularly vacation homes, you will likely get a different story.

Of course not everything is positive, there are some cons to owning your own building; the most obvious being the increased risk. When a business signs a 5 year lease the commitment is for those 5 years only, on the other hand a 20 year mortgage obviously represents a 20 year commitment. In addition, very rarely does a landlord require a business owner to sign a lease personally. If you're a small business owner signing your first business mortgage you will likely be personally responsible for the debt. As with all business decisions, the risk and return have to be analyzed carefully before taking on the long term commitment of being your own landlord.

If you have been looking for new office or industrial space recently, you know it's a great time to be a tenant. Vacancy rates are high and there are deals to be made. Not only are rental rates

low but concessions such as free rent and more than standard build-out allowances are readily available. Although this situation is likely to persist, it won't last forever, however any deal you make now will result in an improved bottom line throughout the lease term. Besides, it is much easier being a tenant than a landlord.

As I've alluded to, owning your own building means you really have a second business to run since you must now operate and maintain your building. If you're only using part of your building then you will also have the duties of being a landlord. This can be more responsibility than you and your team want to take on or have the time or experience to handle properly. The depth of your management team must be assessed to insure the new burden of owning a building does not detract from operating your business.

Obviously the decision to lease or buy depends upon the deal, but overall I believe that business owners are well served to own their own building. As a tenant what is your rent doing? In the simplest terms, your rent is creating equity for your landlord. Your landlord may be a great guy, but a better use of that equity would be not only applying it to your building but also to increase the value of your brand, business and ultimately your net worth.