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Buy or Rent?

Figuring out the best options in today's real estate market

by Bridget McCrea

March 25, 2008 -- There comes a time in every growing company's life cycle when its leaders must step back and ask themselves: Should we own or rent our commercial real estate space? This moment of truth typically hits when companies are growing and looking for space either to accommodate new hires and equipment or to conquer new geographic territories.

There is no easy solution to the buy versus lease question. "A variety of factors pertinent to the individual business and the owner's objectives, as well as local market factors, must be taken into account before an informed decision can be made," says Michael Merino, vice president at the real estate brokerage of Norris, Beggs & Simpson in Portland, Oregon.

Merino tells companies to consider two key factors before choosing: 1) growth potential; and 2) future sustainability. Is your company expected to grow dramatically over the next three to five years? Then owning is probably not a good choice. "Don't stumble by purchasing a building that only accommodates current space needs," says Merino, "and that will be too small in a few years." Here are some other considerations:

Don't Get Stuck

By leasing, companies avoid getting stuck with costly, empty space in buildings that are too large, Merino says. And there are other advantages: credit ratings are less important; there's no need to worry about selling if a quick move becomes necessary; and monthly rent translates into a tax deduction.

On the other hand, rental rates go up regularly, depending on market conditions; rented property doesn't build equity; and tenants may be forced to move out when the lease expires. Property owners, however, can deduct both for annual depreciation and the interest paid on their mortgage; they can make changes to the building to accommodate their operations; they avoid rent increases; and can lease out extra space to other tenants.

But keep in mind that property values may decline, and that purchasing typically requires a greater initial outlay of capital to secure financing. Also, real estate ownership can bring with it more responsibility, since you'd have no landlord to call to remove snow from the parking lot or to repair the roof. These seemingly minor housekeeping matters add up and require time, money, and manpower to handle effectively.

More Money

When deliberating the buy versus lease choice, be sure to consider whether your company will make more money out of investing in the business itself versus investing in real estate. "Even large, successful companies choose to lease because the firms can be more profitable putting money into their business," says Merino, who urges midsize firms to analyze current market conditions and available comparable sales information before making any decisions to purchase or lease.

Rachelle Ginsberg, a real estate associate with Douglas Elliman Florida in Miami Beach, says leasing versus owning is a subjective choice that companies make based on their philosophy, wherewithal, financial objectives, and growth. "Many companies just don't want to be in the real estate business, particularly if they have multiple locations," she says. "They're more concerned about flexibility in running their business and adapting to change."

Take national drugstore chain Walgreens, whose strategy is to build a store and then sell the real estate. "Like most companies, Walgreens would rather have capital for expansion," says Ginsberg, who sees purchasing as an option for smaller, local companies that intend to stay in one location. "If they have the financial stability, these firms are more likely to buy as opposed to leasing."

Ultimately an outright purchase of business property would best be considered by a company that's been around for a few years and has concrete projections to grow significantly, Merino says. "If you know that you can manage your company effectively in the same building for 10 years or more without additional space," he says, "then take a hard look at the cost differences between leasing and owning."

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