

## **Entrepreneurs Facing Lease Vs. Own Decision Need to Take Long-Range Outlook, Expert Says**

Fledgling entrepreneurs -- be they owners of accounting firms, machine shops, local restaurants, clothing stores, dry cleaning establishments or other small businesses -- face the question of whether to lease or own the property housing their business.

According to a national commercial real estate expert, there is no "right" or "wrong" answer. 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.

" Whether or not the company will grow -- and grow substantially in the future -- is one of the principal factors influencing the lease versus own decision," said John McCrocklin, CCIM. "If the business is expected to grow dramatically over the next three to five years, owning is probably not a good option. An entrepreneur is better off leasing in that situation.

" By leasing, the entrepreneur avoids the prospect of either purchasing a building that's too large, with the expectation of growing into it, or one that only accommodates current space needs, which will be too small in a few years," McCrocklin, continued.

The next issue to consider is the availability of flexible lease terms. "Landlords in many markets today offer a long-term lease of seven to 10 years with a clause allowing the business to exit the lease after five years with six months notice," McCrocklin Said said. "In this case the tenant would pay the unamortized cost of getting out."

McCrocklin emphasized that obtaining this kind of lease flexibility for small entrepreneurs is a more prudent option than owning real estate.

" Small business owners initially should try to avoid tying up valuable capital in real estate assets," said McCrocklin. "Leases tend to lower fixed costs because there is no required down payment or amortization of loan principal. Lowering fixed costs reduces overall business risks."

Leasing real estate offers a business the option to still occupy and control a property, but utilize capital in other ways, McCrocklin said.

From the perspective of purchasing a business property, McCrocklin said that an entrepreneur in business a few years with few plans to grow the business significantly might consider an outright purchase. "If a business owner knows he can manage the company effectively in the same building for 10 years or longer without requiring additional space, then he should take a hard look at the cost differences between leasing and owning.

" In this case, owning appears to be a viable option," McCrocklin continued. "But even with ownership there are pitfalls. If you purchase the property and 10 years in the future the business gets into financial difficulties, you as the owner do not have the flexibility a lease would offer. If you file for bankruptcy and you are a tenant, it is most likely you can tear up the lease and claim you need to move to a lower cost building in order to get back on your feet. An owner simply does not have that flexibility."

Another problem with ownership, according to McCrocklin, is it "carries a potential opportunity cost. Owning real estate through either equity or mortgage loan financing ties up capital that might otherwise be invested in the business, for expansion or renovation. Such operations investment might produce greater returns than the real estate investment, creating an opportunity cost that accompanies real estate ownership."

If the entrepreneur opts for a lease over ownership, certain criteria must be followed in order to secure the best possible lease. For example, leases should provide the tenant with an acceptable level of control over the asset. These control issues include assignability, reasonable condemnation and taking provisions, and purchase options. Lease escalation clauses should be manageable and potentially tied to sales growth in order to lessen downside risk.

If the entrepreneur opts for purchase, when to make that purchase is paramount to getting the best

price. Analyzing current market conditions and available sales information provides the buyer with valuable insight. The [CCIM/Landauer Investment Trends Quarterly](#), an analysis of transaction data, is an excellent source of regional and national market activity.

Lease vs. own analysis is definitely a situation-by-situation equation, McCrocklin. "There are many factors to consider and the decision should be made in conjunction with a qualified real estate professional who has proven experience in that particular market," McCrocklin concluded.

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