KeyBank
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Answering the key business real estate question: buy or lease?

When it comes to real estate, finding an ideal business location is often complicated by the question of whether to buy or lease commercial space. What are the short- and long-term costs with each option? And when is it necessary to seek out the services of a financial advisor?

If you're at the point of contemplating this critically important question, take a look at the benefits and shortcomings of each choice.

The pros and cons of leasing

Among the virtues of a leasing strategy is that your business isn't required to come up with a significant down payment typically required for a commercial real estate purchase (anywhere from 10 to 30 percent of the purchase price). By contrast, a typical commercial lease entails paying the first and last month's rent and possibly a one-time broker fee. Therefore, you can make strategic investments of your available cash to expand operations, purchase equipment, hire new staff and so on—options that might not be available after deciding to buy office or retail space.

Pros of leasing

- Rent and rental expenses are tax-deductible, as are lease payments unless affected by new lease standards.
- You may be able to lease property in a more prestigious, higher-end location.
- Depending on the lease arrangements, a landlord may be responsible for all repairs and maintenance.

Key takeaways

Rent and rental expenses are tax-deductible, as are lease payments.

When buying, you may have the option to add to cash flow through leasing or subletting.

Consulting with a financial advisor can help you sort out what's best for your business.

Cons of leasing

- The potential for rent increases, particularly if annual escalations are incorporated into the lease.
- A property that you lease offers no equity to your business.
- As a tenant, you could be legally obliged to vacate the property at the end of a lease agreement, thereby incurring the costs of relocation.

New lease standards on the horizon

There are additional considerations when it comes to leasing, due to new lease standards released in 2016 by the Financial Accounting Standards Board (FASB). Though these new standards don't come into play until December 15, 2018, for publicly owned companies, and December 15, 2019, for private companies, they could influence your decision to lease or buy.

Primarily, the new standards require that leases of greater than 12 months be listed on a company's balance sheet as both an asset and a liability—even if, as Forbes reports, "the tenant's intent is to return the asset to the landlord." Just as importantly, Forbes reports, "The rent obligations these leases reflect are essentially recognized as debt—the kind of debt that will impact a company's credit, loans and capital requirements."

Advantages and disadvantages of buying

According to *Independent Retailer,* one useful rule of thumb when considering the purchase of commercial space is not to make the decision to buy solely for the sake of ownership. Purchasing office space or retail property only makes sense "if you would be prepared to lease that same location anyway."

Perhaps the greatest benefit of buying is the equity your business stands to build over time. Equity offers considerable advantages in terms of its use as collateral for growth-related expenses. Plus, a fixed business loan is also a "fixed" expense—monthly payments will not change during the entirety of a loan period.

Pros of buying

- Tax deductions on annual depreciation costs.
- The option to lease or sublet available office or retail space to tenants, which can add to cash flow.
- The ability to improve or modify office or retail. space as you like, without needing permission from a landlord.
- If and when the time comes for you to sell, there's the potential to reap a sizable profit in an expanding real estate market.

Cons of buying

- The commercial space may not be located in the most desirable area, depending on your company's financing ability.
- The upfront expenses needed to purchase office or retail space may preclude meeting key growth objectives, due to a lack of available cash.
- As owner of the space, it's your responsibility to pay for all property maintenance, repair expenses and applicable property taxes.
- You run the risk of declining property values in the years to come.

The issue of business real estate becomes, sooner or later, a top priority for every growing company. With all of the factors described above to consider, consulting with a relationship manager to help you sort out what's really best for your business could be the most prudent first step.

To get started, contact your relationship manager today.