VANCOUVER BUSINESS JOURNAL
The Key to Southwest Washington Business

Column: Owning versus leasing

By Jim West April 1, 2011

We've seen two regularly occurring themes in the Real Estate & Development section of the Vancouver Business Journal over the past couple of years. First, owning your business property versus leasing is an excellent way to protect and grow your wealth. Second, the impact of the Financial Tsunami of 2008 and subsequent Great Recession has presented business owners with a tremendous opportunity to own their business property with financial fundamentals that make long term sense.

There are several positive factors worth noting:

- **Interest rates remain at historic lows**
- **Properties can be acquired at values that make sense**
- **Owning will allow you to build equity through amortizing the loan**
- **Banks prefer lending on owner occupied properties and are eager to do so**

The decision to own should be driven by the kind of return you will get on the capital you allocate to the property, compared to the numerous alternatives you might find in other investment options. Could you expand, add new product lines or buy a second operation? Perhaps you could invest in stock of a start-up company, or hire an investment adviser to recommend stocks, bonds, mutual funds, exchange traded funds, currencies or bank CD's; The options are many.

What are the financial dynamics that actually show why this is a good strategy? I've laid out a simple scenario below. (*see chart on following page*)

I'll preface it with the following disclaimer: there are many variables in every business and real estate transaction that can impact the overall return. These can include tax brackets, differences between lease rates and loan payments, and market conditions that impact your acquisition and disposition costs. This example does not try to take into account every one of those.

In addition, I'll use two equity strategies in owning a property. One a traditional lender, using a formula of 75% loan to 25% capital contribution from the borrower, and a second that uses a 504 program loan from the Small Business Association (SBA), which requires only 10% down.

We'll look at a ten year time horizon, and assume the property is always worth the beginning loan value.

Assumptions:	**Interest Rate 6.1%**	**Amortization 20 Years**
Acquisition Costs **$ 700,000**	**Improvements** **$ 300,000**	**Total Project Costs** **$ 1,000,000**
Lender **75% LTV**	**Capital Invested** **$ 250,000**	**Monthly Payment** **$ 5,416***
Equity Buildup	Amount	Rate of Return
5 Years	$ 112,206	7.43
10 Years	$ 265,000	7.25
SBA 504 **90% LTV**	**Capital Invested** **$ 100,000**	**Monthly Payment** **$ 6,499***
Equity Buildup	Amount	Rate of Return
5 Years	$ 134,500	9.26
10 Years	$ 316,966	8.37
** Rate of return accounts for difference in monthly payment*		

Your first inclination may be to look at these rates of return between 7.25 and 9.26 percent as being pretty pedestrian. I would suggest they are stable and conservative. They are based solely on the equity buildup that occurs from you paying monthly loan payments. Compare that to investment returns in categories mentioned above over the past decade both in rate and in volatility.

The following factors will provide additional benefits:

You are the person responsible to pay the return to yourself

You are not at the mercy of an emotional ride on the roller coaster stock market, a money manger's performance, or a Federal Reserve sustained artificially low interest rate policy. You can see, touch, manage and protect your asset as you see fit.

Appreciation from inflation

Assuming a historical 3 percent inflation rate raises value of the property, those returns increase to 10.4 and 11.7 percent.

You will have fixed your real estate costs for twenty years

This is a key financial strategy during inflationary times. Real estate costs are often the third or fourth most expensive P&L line item. You will gain a competitive advantage from this, either through grabbing market share because you can keep prices down, or by being more profitable.

You will have greater options

Selling your business may be part of your exit strategy; otherwise, you will have created an asset that can provide you a very stable source of future income.

We have experienced 21 months of slow sustained economic recovery. There is an expanding general consensus across most economic forecasts that 2011 and 2012 should provide continued growth. However, there are problem clouds on the horizon, especially when it comes to inflation. This key indicator is already impacting building costs, land values and making it problematic to maintain current low interest rates. In 2015 or 2016 many will look back and say, “I only wish I had stopped leasing and bought my business property.”

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