

Buy or rent office space? Here's how to decide

By Joseph Anthony - Microsoft Small Business Center

Sooner or later, every business has to consider whether it is better off owning or leasing office space. From law firms to retailers to yoga studios, the decision varies. But here are some elements that most small businesses take into account.

The cash outlay factor: Generally, you don't need to put out as much money upfront when you lease as you do when you buy. A quick example: A real-estate agent is looking to sell a \$500,000 commercial property. Someone leasing the space might pay around \$4,000 monthly in rent. Someone looking to buy the building would have to put about \$150,000 down, and also would have had to pay for an appraisal, building inspections, loan fees and other costs. **The fixed/variable cost factor:** Buy a building and you have a good idea of what your costs are going to be year after year, especially if you get a fixed-rate loan on the property. Lease and you're subject to the vagaries of the market when your lease term expires. Many leases also have a clause allowing for an annual cost increase tied to changes in the Consumer Price Index or some other measure.

The growth factor: Buying a building that's just the right size for you now can look attractive. But what will you do if your business — and your space requirement — grows over the next few years? Outgrowing a space doesn't have to be a financial crisis. One wholesaler I know saw his business increase so much in five years that he needed more than twice the space of the building he'd purchased. He was able to lease out the building at a profit, and moved his own business into a new, larger space. Still, growing out of a place you own can involve more upheaval than growing out of a leased space. Sometimes a growing business can avoid the cost and hassle of moving by simply leasing more space in the building it occupies. That's not an option when you own a building unless you're only occupying part of it and can terminate the lease of another tenant.

The appreciation factor: Buying a building puts you in a second business: real estate investing. If you're in an area of appreciating land values, eventually you could sell it at a profit. But if you own a building with more space than your business needs, you'll probably end up renting to others, thus becoming a landlord. It can all be profitable (or a financial drain in a down market), but what it is sure to be either way is more work than simply leasing space.

The tax factor: As usual, there are tax issues to consider. Businesses routinely can deduct the full amount they pay in rent. Owners of rental property can write off repairs immediately, but improvements to commercial real estate have to be deducted over 39 years. Depreciation on commercial buildings also is taken over 39 years. That means that if you buy a commercial property for \$250,000 and the land is valued at \$60,000, you can write off only slightly less than \$5,000 of the purchase price annually, regardless of the size of your down payment. You also can deduct interest on the purchase loan, property taxes and other qualifying expenses. Attorneys may recommend placing a commercial property inside an entity such as a limited liability company (LLC), with the LLC then leasing space to other businesses — including your own. The reasons for, and logistics of, doing this are too complex to explore fully in this column. The best advice I can give you is to consult with your attorney and tax professional about the legal and financial considerations of owning investment property.

Getting more help

In general, leasing tends to appeal to businesspeople who don't want to make the kind of large upfront investment required with a purchase, who aren't really sure how much space they'll ultimately need and who simply don't want to have to deal with the responsibilities of owning a piece of commercial property. Buying is going to make more sense for businesspeople who are more established, who want to be in one location for several years and who have the financial resources to take on a significant real estate investment. Some of the basics of comparing leasing to buying (trying to predict future price appreciation, considering cash-flow issues and factoring in the cost of a down payment on something you own versus rental payments that don't build any equity, for example) are similar to issues involved in deciding whether to lease or buy a house.

Joseph Anthony is a tax professional in Portland, Ore., who writes about finance and tax issues affecting small businesses.