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Buy or Lease Business Space?

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You own a business. Should you also own the property that houses it? Deciding whether to buy or lease commercial space requires balancing short-term considerations with long-term plans.

Weigh the business' current cash flow needs and growth rates against how much you will eventually need from the sale of the business to fulfill your lifetime goals.

In my experience, entrepreneurs who own the building when they are ready to sell their business often find themselves in a better financial position than renters. Although owning and leasing have a similar lifetime expense equation, in the end, owners end up with two assets instead of one.

As a result, ownership affords more options. For example, the owner can sell the business but keep the building – and generate income by leasing it out. A tenant is left with little more than equipment and a customer base to sell.

Still, before you buy, take two keys steps to see if that is the best move:

1. Perform a thorough market analysis. What is the market for the type of space the business requires? Does the nature of the business narrow down where you locate it? Are there zoning restrictions?

How much money is available for the purchase? Is there a budget for improvements? Is financing available? Is the building in a growing or successful geographic area? Will it be easy to sell the space when the business no longer needs it?

If the answer to any of these questions is no, consider leasing for now.

2. Conduct an honest appraisal of the business. If it is struggling, purchasing isn't a great idea. Once the property is bought, the business is committed for the term of the loan, which is usually longer than the term of a lease.

Should the business fail, the owner is left with a large payment on an empty space and may be unable to afford the rent.

It also could be a bad idea to purchase property for a fast-growing company. A successful business may expand so quickly that it outgrows the space before the owner can afford a bigger building. Example: a solar panel manufacturing company, poised to take advantage of the green revolution, that needs more and more room for equipment and inventory as the business ramps up. It often makes sense to lease until growth stabilizes.

My experience doing such an assessment of my own small business illustrates these concepts nicely. Just over three years ago, I began looking to purchase or lease new office space under the guidance of John Norheim of Norheim & Yost, a commercial real estate broker in Berkeley, Calif. John has a lot of knowledge and a lot of patience, which is important, because I had several concerns to address before I took the plunge.

My biggest concern was getting value for any dollars I spend. During the past three years, whenever I've performed a market analysis, I've found sale prices to be too high — so I have stayed put. I want a lot, but I also want a good price. While I believe prices are still too high, this is slowly changing. The glut of office space in San Francisco has driven down purchase prices and lease rates by 25% to 30%. I'm hopeful this will spill over to the East Bay, where my firm is.

While my market analysis says it may not be the time to buy, my business appraisal suggests there is ample opportunity for my firm to grow. So I haven't abandoned my search. There are four topics business owners should consider:

1. **Ease of access.** Roughly 75% to 80% of our clients are located in Berkeley or Oakland, so we need a location central to this area and easily accessible to parking and public transit. Parking is better in West Berkeley and public transit is better downtown. North Berkeley has both, which is one reason we're still there.

2. **Location, location, location.** Our current office is on the third floor of an architecturally interesting building in the Gourmet Ghetto, a neighborhood with many great restaurants. We have great views and spectacular food, steps from our door, so it is tough for us to consider a traditional mezzanine office space in West Berkeley's industrial area. Emeryville might work, but Oakland would create an impossible commute for my team, who all live in Berkeley.

3. **The right environment for the business.** We are wealth managers, so we require class A space. It is paramount that clients find the office sophisticated, comfortable and inviting. My staff and I put in long hours, so we also need to love where we work.

4. **Room to grow.** Any space has to accommodate our growth for the next five to 10 years. I haven't yet decided if we'll train brand-new advisors, who share an office, or hire experienced ones, who need their own. Either way, I'm committed to a more Main Street business model that offers the current staff plenty of opportunity – and room – for upward mobility.

Today, I am considering leasing a larger space for three to four years. But I'm waiting before taking the leap, because I think we might have an opportunity in the next 12 to 18 months to buy a building that will fit our needs for years to come.

Every business owner must resolve his or her own unique concerns before deciding to lease or buy. Under the right circumstances, owning may be the ideal from a long-term planning perspective, but only if it makes sense for you.

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