Buy or lease?
Committing to your space

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"Buy land. They ain't making any more of the stuff."

Whether you attribute that quip to Will Rogers, Mark Twain, or even recall a similar line from "Gone with the Wind," the message is clear: The smart man's money is on property ownership.

But is this an antiquated school of thought? Is ownership always preferable to renting, or leasing, your business space?

Jim Thomas, Electrical Rebuilder's Association (ERA) past president and owner of Smith Auto Electric in Yakima, Wash., said the advantages of owning "far outweigh" leasing.

"Anybody in business today needs to have something that provides for their future," said Thomas. "If you're just working for a living without building anything for your future, you won't have anything when you're done. Commercial real estate has been the one solid thing to invest in. In a retirement scenario, the real value is in the property, not the business."

Smith Auto Electric operates out of a 6,000-square-foot building which was a pizza parlor in its former life. Thomas said the false ceilings and walls were easily gutted to fit the floor plan he needed for a shop. In addition, the 8,000 square feet of parking allowed him to install a chain-link fence for ample secure storage of customer vehicles.

Thomas personally purchased the property from the owner on contract and leases it to Smith Auto Electric. This has been an "exceptional" situation for them.

"When you can buy a commercial piece of property and have the business pay for that property, that's where the advantage is. That's what works for me and most tax consultants will tell you that's what works best. You're doing something for yourself personally and putting yourself in a better position regardless of what happens to the business," he said.

Thomas has a written agreement with the corporation which is reevaluated every five years and adjusted to account for changes such as property tax increases.

He understands that purchasing property is not an option for all small businesses.

"It depends on where they fall in the food chain. It's hard for a small rebuilder to buy a building if he doesn't have a documented cash flow and a good relationship with his bank," said Thomas. "But if you get all the ducks in a row, in 25 years you've got something that's going to put money in your pocket."

He cautions against making "emotional" commitments and stresses the importance of documenting answers to key property questions:

- Is it zoned properly? If you are doing on-car work it is especially important to make sure the property is zoned for this type of activity.
- Is it insurable? An email quote from an online company is not sufficient. Talk to a person and get the insurability guarantee in writing.
- Is it secure and easily accessible for customers and employees?
- Is there a pre-payment penalty on the note? Or a large balloon payment you need to plan ahead for?
- Is there room for expansion? Moving is expensive and inconvenient!
- Is it a reasonable distance from your nearest competitor?
- Have you consulted the proper real estate, tax and legal advisers?

One other area that is a bugaboo for industrial property is its environmental condition.

"You've got to make sure that somebody wasn't digging a hole and filling it with oil. That problem will come back to roost," said Thomas. "That's another reason to look to a commercial real estate person when purchasing property."

Travis Helgeson, associate office broker with commercial real estate company Kessinger/Hunter of Kansas City, said whether you choose bank or owner financing, purchase or lease, it's vital to run all your paperwork by a real estate adviser.

"There are so many liabilities involved on both sides of the table and so much gray area when leasing space, or even buying space, you need someone who understands the market and the language," he said. "Especially in leasing, you need to know who is responsible for what."

When meeting with prospective clients, Helgeson first advises them to examine their business model.

"You need to know what your three-year or even your five-year plan is for down the road," he said. "Are you looking to grow? Do you want the capital tied into property? They may want to invest cash back into the business instead."

Helgeson said that today's tough market has created endless variables in available properties, prices, terms, interest rates, and financing options.

"What we're seeing now, because a lot of landlords can't get rid of property, is an increase in owner financing," said Helgeson. "And we are starting to see a little bit of banks loosening up loan criteria, although it is more of an extensive process to get qualified for a small business loan versus a residential loan."

He said purchasing in today's climate "makes a lot of sense."

"Right now is a great time to buy because the market is just bad. Owners are defaulting and the banks want to get those properties off their books."

Larry Hagemeister, another ERA past president, and owner of HEI, has the best of both worlds with a location he owns in Lebanon, Ore., and another he leases 110 miles down the road in Redmond, Ore.

He purchased the business and 2,500-square-foot Lebanon shop from his uncle on contract 27 years ago and paid it off in six years. He leases the property and its contents to HEI.

"It's good business because when you own a building you have something to sell, although this economic climate has to improve greatly before we can be sure our buildings are going to be worth anything," he said.

HEI purchased the Redmond business, but not the property, from a former customer about seven years ago. He leases the 3,500-square-foot space from the building owner. He chose to lease instead of moving the business and taking on the additional risk of owning the property.

Neighboring businesses create a lot of traffic and are a boon to his advertising. There is even an antique mall across the street which hosts an annual car show and HEI provides free food as part of the festivities.

"Man, that's a deal," said Hagemeister. "That's some good advertising. It has been a great situation."

He advised that it is probably best to lease when just starting up a business because it simplifies things if you have to walk away.

"I would opt for leasing a building first and make sure you're going to make it. If you've signed the paperwork on a business and it doesn't work you don't want to also be tied to a piece of property," he said. "Maybe then as things progress you can buy it."

He said as a new business owner it's also beneficial to know your "true overhead cost."

"If you're leasing it's all on the table. You always have that payment and you can always figure the true cost."

Carolyn Grube, co-owner of JIMCO, Inc., said she and husband Juan bought a prefabricated steel building in 1979, intending to erect it on the farm where they live in western Missouri. The zoning board promptly squashed those plans and JIMCO's new building finally came to rest on a 10-acre piece of land in Raymore.

"Being the product of small town Missouriana, we never even considered leasing," said Grube. "To begin with, there really wasn't anything in Raymore or surrounds to lease. Secondly, our mindset was to buy to own. Although ours was a 'shotgun' purchase, we believe that in time as they city grows it will more than pay for itself."

The Grubes own the structure and adjoining parking lot and lease it to JIMCO.

"There may be advantages to leasing but we're just not into that," she said. "For what it's worth, Juan's dad was a mechanic and a farmer. He always equated leasing property to renting. He was born in 1900 and during his early lifetime, property 'renters' were looked down on. You didn't want to be a renter—you wanted to be an owner. He never forgot that."

ERE

Peer-to-peer lending adds new twist

If you have been frustrated with the banking industry lately, either as a borrower or as an investor, you may be interested in learning about peer-to-peer (P2P) lending. Instead of going to a bank for a business, real estate, or even personal loan, you may now access ready investors through social lending Web sites.

Borrowers choose a loan amount, an interest rate they are willing to pay, and investors then review listings and give a green light to those who meet their criteria.

According to foxbusiness.com, investors have started looking at P2P lending for its "high yield and current income appeal," and use of this Web-based system has grown more than 100 percent in the past year alone.

Check out these companies for a glimpse at the P2P business model: prosper.com; zopa.com; kiva.org; lendingclub.com; or loanio.com. As always, check with your legal and tax advisers to see if this system is right for your situation.