
Knowing when to buy versus rent office space

For a business owner, deciding whether to lease or buy office space often involves a leap of faith.

That's especially the case when economic uncertainties make the future less easy to predict.

Buying a property represents a much-longer-term financial commitment than leasing and, as such, requires a realistic assessment by the potential purchaser of the company's future prospects.

Companies anticipating significant growth need to decide whether to purchase property that is large enough to accommodate that growth over time and, if the space is initially too large, whether and for how much they will be able to lease the excess space to a tenant until it is required. The potential rental income that leasing surplus space might generate for the purchaser also should be part of the equation.

Space is much less of an issue when leasing an office since, if it becomes too small — or too large — the company has the option of not renewing its lease and moving elsewhere.

That flexibility also can be useful if market changes over time indicate that a move to a different location would be advantageous. On the other hand, renters can be faced with unwelcome disruption should the landlord, for whatever reason, decide to terminate the lease.

Deciding to purchase also commits business owners to a much larger upfront cash outlay than the leasing option. The initial outlay when purchasing will include not only a substantial down payment but also the cost of inspections and appraisals, loan-related fees and other closing costs. The upside is that, in contrast with a firm that leases space, the purchaser will, in time, own an asset that can be sold — hopefully at a profit.

According to online office space referral and information network OfficeFinder LLC, business owners purchasing office space can expect to make a down payment of between 10 percent and 25 percent of the purchase price. By comparison, the upfront cost involved in leasing a space usually is limited to just a couple of months' rental.

Another factor potential buyers should consider is the effect of the down payment on working capital available to finance the company's growth.

Having considered a company's growth potential and the upfront costs, a number of other issues should factor into the buying vs. leasing decision.

They include taxes, maintenance costs and potential interest and rental rate changes, among others.

Renters, for example, usually don't have to worry about regular maintenance costs, as these normally are the responsibility of the property owner. However, should they wish to make significant alterations to the leased space, they can do so only with the landlord's consent. Property owners, on the other hand, are free to make whatever changes they wish.

Purchasers also have the advantage of knowing in advance what their future monthly loan payments will be, especially when they have negotiated a fixed-rate loan. Tenants, on the other hand, are likely to face regular increases in rental rates and need to budget accordingly.

Leasing initially may look like the cheaper option, says Tim Hatlestad, president of the Certified Commercial Investment Member Institute, but to help reach a decision, business owners should carry out an after-tax analysis to determine what can be written off, as renting and buying offer different benefits.

"If everything else were equal, then you have to look at the options after taxes," Hatlestad says. "The after-tax analysis, through a number of measures, will tell you what costs less."

Property owners, for example, are eligible for deductions of property taxes, mortgage interest and depreciation among other things, while those who lease office space usually can deduct the full amount of the rent as a business expense.

Jim Osgood, CEO of OfficeFinder, says the stage a business is in its life cycle can be an important factor in determining whether to buy or lease. A more established business should consider buying office space, he says, since anticipated growth is easier to predict accurately. A startup, on the other hand, would probably be better to lease an office, as it would provide greater flexibility and fewer constraints to growth.