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Make $158,000 per Year for 25 Years!

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Have you ever wondered why people invest in commercial real estate? For owner-occupied buildings, it can make a great deal of financial sense to own.

Before leasing to someone else, investigate the pros and cons of owning your own building; there is a dramatic investment potential difference.

In order to compare the costs of leasing and owning over a 25 year period, the following is a calculation and comparison of leasing versus owning 5,000 square feet. Tax incentives are not included in the calculations are there are far too many variables to factor. In most cases, though, the tax incentives, are more advantageous for the owner of the building and not the leasee.

The bottom line is that the initial out-of-pocket costs for a lease can be very comparable to that of investing in a new building, especially if you are responsible for the leasehold improvements (construction costs). The difference is seen in the long run. After a 25 year period of leasing, there is no asset; absolutely zero. In the same period when owning a building and leasing it back to a practice, there is a potential asset in the millions of dollars.

Please note: As with all investments, there is risk involved as real estate markets fluctuate, loan terms change, tax codes change, and appreciation can only be estimated using historical data which is not guaranteed to repeat. The example shown is not a guarantee. Your situation may be different.

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Ownership Example

Total project costs including: construction, taxes, permits, inspections and testing, reimbursable expenses, attorney fees, construction loan interest, signage, site survey, legal costs, professional design and engineering fees, and contingencies is roughly $950,000 or $190 per square foot. We will also add the cost of land at $150,000 to the total cost for a total project cost of $1.2 million.

We will assume a lending rate of 6.00% with a 25-year amortization with a 20% down payment:

TOTAL PROJECT COSTS	$	1,200,000
Less 20% down payment		240,000
Total amount financed	**$**	**960,000**
Monthly lease payment ($23/square foot)		9,200
Monthly lender payment		(6,185)
Monthly operating costs ($5/square foot)		(2,000)
Monthly 1st year cash flow	**$**	**1,015**

Projected Returns on Original Investment of $240,000

Year	Monthly	Yearly	% Return	Year	Monthly	Yearly	% Return
1	**$ 1,015**	**$ 12,180**	**5.08**	14	$ 4,388	$52,658	21.94
2	$ 1,231	$ 14,768	6.15	**15**	**$4,705**	**$56,464**	**23.53**
3	$ 1,453	$ 17,438	7.27	16	$5,032	$60,385	25.16
4	$ 1,682	$ 20,192	8.41	17	$5,369	$64,423	26.84
5	**$ 1,918**	**$ 23,020**	9.59	18	$5,715	$68,652	28.58
6	$ 2,161	$ 25,938	10.81	19	$6,072	$72,867	30.36
7	$ 2,412	$ 28,947	12.06	**20**	**$6,440**	**$77,279**	**32.20**
8	$ 2,670	$ 32,038	13.35	21	$6,819	$81,824	34.09
9	$ 2,935	$ 35,225	14.68	22	$7,209	$86,506	36.04
10	**$ 3,209**	**$ 38,509**	16.05	23	$7,611	$91,328	38.05
11	$ 3,491	$ 41,891	17.45	24	$8,025	$96,294	40.12
12	$ 3,781	$ 45,374	18.91	**25**	**$8,451**	**$101,410**	**42.25**
13	$ 4,080	$ 48,962	20.40				

Also, if we estimate that the property averages 3% appreciation per year, we find that after 25 years, the property would be worth $2.3 million; $1.3 million more than it cost to build.

Lease terms back to tenant (leased back to your practice)

- Leasable area = 5,000 square feet
- Full-service lease rate = $23 per square foot, including taxes ($18 per square foot NNN (triple net)
- 25-year lease
- Yearly CPI (Consumer Price Index) increases (assume 3% yearly)

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Total Lease Collected Over 25 Years (w/escalation):	$3,150,000
Total Operating Expenses Over 25 years:	$ 875,000
TOTAL COST	**$4,025,000**
Total Cost in Lender Payments:	$1,856,000
Total Profit to Building Owner after 25 Years:	$1,295,000
Total Return on Investment	
Total Profit to Building Owner after 25 Years	$1,295,000
Building Value (Asset) in 25 Years	$2,300,000
TOTAL RETURN	**$3,595,000**

OWNERSHIP EXAMPLE RE-CAP:

TOTAL OUT-OF POCKET INVESTMENT	**$ 240,000**
VALUE OF ORIGINAL INVESTMENT AFTER 25 YEARS	**$3,595,000**

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Leasing Example

Terms

- 25 year lease term
- $30 per square foot tenant improvement construction allowance (actual construction cost = $60 per square foot)
- $23 per square foot per month (full service) with yearly escalation clause (CPI)
- 15% common space rent (5,000 square feet x 15% = 750 square feet)
- Total lease square footage = 5,000 square feet + 750 square feet = 5,750 square feet

Total Lease over 25 Years of lease (w/escalation):	$4,820,000
Construction Cost ($30/SF Difference):	$ 150,000
Opportunity Cost Gain ($70,000 @6% X 25 Years)	$ 243,000
TOTAL COST	$4,727,000
Total Return on Investment	
TOTAL RETURN	$ 0
Initial Cash Outlay for New Lease Space	
First and last month's rent	$ 20,000
Construction Cost ($30/SF Difference):	$ 150,000
TOTAL OUT-OF-POCKET INVESTMENT	$ 170,000

OWNERSHIP EXAMPLE RE-CAP:

TOTAL OUT-OF POCKET INVESTMENT $ 170,000

VALUE OF ORIGINAL INVESTMENT AFTER 25 YEARS $ 0

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Summary

The comparison above shows the potential investment strength of building ownership. In the above scenario, the total cost of leasing is over $4 million in an owner-occupied building and roughly $4.8 million in the leased office. The main difference is that in the owner-occupied building in the first example, the building owner makes a return of over $3.5 million and the strictly leased suite has no return at all. The out-of-pocket costs are relatively comparable.

Also not that in the lease example, if there was no tenant improvement allowance for construction of the suite, the out-of-pocket costs for the lease would be higher than that of the new building.

In the long run, all things equal with stable returns, building ownership has its financial rewards. Ultimately, the decision is a personal one and as with all investments, there is risk involved. It is worth carefully considering the pros and cons of each. Do your research, use the expertise of professionals and make informed decisions. Do not base decisions on the opinions of a single colleague as the final decision requires thoughtful input from many. Your accountant may strictly look at the decision from a tax perspective; not taking into account wealth or personal financial planning goals. An attorney may give legal advice, but they may not be experienced in providing investment advice. What works for one orthodontist is not solution for all. Plan to make your decision work best for you personally and professionally.