

**Commercial Board of Realtors  
Lease vs. Buy Illustration  
Office Space**

**ASSUMPTIONS:**

**Operations** Sq. Ft. 10,000

**Property value:**

year 1 NOI 95,000  
Cap rate 7%  
Value 1,357,143

**Capital Structure:**

Equity 30% 407,143  
Debt 70% 950,000  
Total capital and cost 1,357,143

**Debt terms:**

Period 7 years  
Amortization based on 20 years  
Interest rate 3.75%  
Monthly payment 5,632.44

**Operations - base year**

Rent 17.50 per ft  
Operating expenses (8.00)  
Net operating income 9.50  
less debt service (6.76)  
Cash flow before distributions 2.74

**Annual depreciation - 39 years on 80% of cost** 27,839 (20% allocated to non-depreciable land)

**Inflation rate** 2.50%

**Real estate appreciation rate** Computed based on same 7.00% acquisition cap rate/yield (95,000/1,357,143)

**Tax rates (federal and state):**

Ordinary income 40.00%  
Section 1250 recapture on assumed sale 31.00%  
Capital gains 21.00%

**Selling expenses** 4.00%

<u>Year 1</u>	<u>Year 2</u>	<u>Year 3</u>	<u>Year 4</u>	<u>Year 5</u>	<u>Year 6</u>	<u>Year 7</u>	
175,000	179,375	183,859	188,456	193,167	197,996	202,946	Rent income-base
0	2,000	4,050	6,151	8,305	10,513	12,775	Rent income-passthrough
(80,000)	(82,000)	(84,050)	(86,151)	(88,305)	(90,513)	(92,775)	Operating expenses
95,000	99,375	103,859	108,456	113,167	117,996	122,946	Net operating income
(67,589)	(67,589)	(67,589)	(67,589)	(67,589)	(67,589)	(67,589)	Debt service
27,411	31,786	36,270	40,867	45,578	50,407	55,357	Cash flow

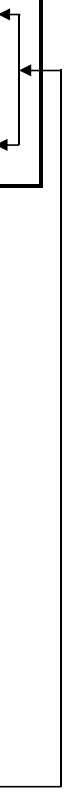
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SUMMARY

<u>Lease vs own comparison:</u>	<u>Owner</u>		<u>Difference</u>
	<u>Lease</u>	<u>Occupied</u>	
Initial investment	0	(407,143)	(407,143)
Cash expensed in operations, net of tax benefits	<b>(818,757)</b>	(670,367)	148,390
Cash received on sale, net of taxes on gain	0	862,037	862,037
Net cash flow over 7 years, undiscounted	<u>(818,757)</u>	<u>(215,473)</u>	<b>603,283</b>
NPV, CF discounted at 6%	<u><b>(647,582)</b></u>	<u>(366,197)</u>	281,385
Cash saved in operations			148,390
Return on investment			454,894
Total difference			<u><b>603,283</b></u>

<u>Lease over 7 years:</u>	
Rent paid	(1,364,595)
Tax deduction	545,838
Rent, net of tax, undiscounted	<u>(818,757)</u>
Discounted NPV at 6%	<u><b>(647,582)</b></u>

<u>Owner over 7 years:</u>	<u>Owner</u>		<u>Investor</u>
	<u>Occupied</u>		
Rental income			1,364,595
Operating expenses and debt service paid	(1,076,919)		(1,076,919)
Tax savings of expenses and interest/(taxes owed)	328,603		(139,286)
Tax savings from depreciation	77,949		0
Operating expenses, net of tax, undiscounted	<u>(670,367)</u>		148,390
Initial equity investment	(407,143)		(407,143)
Proceeds from sale, net of retiring debt	991,532		991,532
Taxes due on sale gain	(129,496)		(129,496)
Net cash from investment and sale	<u>454,894</u>		454,894
Total undiscounted cash flow	<u>(215,473)</u>		<b>603,283</b>
Discounted NPV at 6%	<u><b>(366,197)</b></u>		<b>281,385</b>
Internal rate of return	N/A		14.99%





PDH Saturday, November 13, 2004  
 Commercial Board of Realtors  
 Office Space Annual Cash Flows

**OWNER OCCUPIED**

	12/31/09	12/31/10	12/31/11	12/31/12	12/31/13	12/31/14	12/31/15	12/31/16	12/31/16	Operations Total
<u>Operations</u>	<u>Year 1</u>	<u>Year 2</u>	<u>Year 3</u>	<u>Year 4</u>	<u>Year 5</u>	<u>Year 6</u>	<u>Year 7</u>	<u>Sale</u>		
Rent	0	0	0	0	0	0	0	0		0
Sale price									1,756,376	0
Operating expenses/selling expenses	(80,000)	(82,000)	(84,050)	(86,151)	(88,305)	(90,513)	(92,775)	(70,255)		(603,794)
Net operating income	(80,000)	(82,000)	(84,050)	(86,151)	(88,305)	(90,513)	(92,775)	1,686,121		
less debt service	(67,589)	(67,589)	(67,589)	(67,589)	(67,589)	(67,589)	(67,589)	(67,589)	(694,589)	(473,125)
Net cash flow	(147,589)	(149,589)	(151,639)	(153,741)	(155,894)	(158,102)	(160,365)	<b>991,532</b>		<b>(1,076,919)</b>
Tax benefits (expense):										
Operating expenses and interest	46,028	46,332	46,636	46,942	47,248	47,555	47,862			<b>328,603</b>
Depreciation/recapture on sale	11,136	11,136	11,136	11,136	11,136	11,136	11,136	(60,410)		<b>77,949</b>
Balance of sale gain taxed at capital gain								(69,085)		0
Net cash flow after tax	<b>(407,143)</b>	(90,426)	(92,122)	(93,867)	(95,663)	(97,510)	(99,411)	(101,368)	<b>862,037</b>	<b>(670,367)</b>
NPV at 6.00%		<b>(366,197)</b>								
								Operating expenses	(670,367)	
								Initial investment	(407,143)	
								Undiscounted CF	<b>(215,473)</b>	

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**INVESTMENT ANALYSIS**

	12/31/09	12/31/10	12/31/11	12/31/12	12/31/13	12/31/14	12/31/15	12/31/16	12/31/16	Operations
<u>Operations</u>		<u>Year 1</u>	<u>Year 2</u>	<u>Year 3</u>	<u>Year 4</u>	<u>Year 5</u>	<u>Year 6</u>	<u>Year 7</u>	<u>Sale</u>	<u>Total</u>
Rent-base		175,000	179,375	183,859	188,456	193,167	197,996	202,946		1,320,800
Rent-expense passthrough			2,000	4,050	6,151	8,305	10,513	12,775		43,794
Sale price									1,756,376	0
Operating expenses/selling expenses		(80,000)	(82,000)	(84,050)	(86,151)	(88,305)	(90,513)	(92,775)	(70,255)	(603,794)
Net operating income		95,000	99,375	103,859	108,456	113,167	117,996	122,946	1,686,121	760,800
less debt service		(67,589)	(67,589)	(67,589)	(67,589)	(67,589)	(67,589)	(67,589)	(694,589)	(473,125)
cash flow before distributions		27,411	31,786	36,270	40,867	45,578	50,407	55,357	991,532	287,675
less distributions for income taxes- <u>see below</u>		(12,837)	(15,083)	(17,392)	(19,765)	(22,205)	(24,713)	(27,292)	(129,496)	(139,286)
Net cash flow after tax	(407,143)	14,574	16,703	18,878	21,101	23,373	25,694	28,066	862,037	148,390
NPV at 6.00%		<b>281,385</b>								
Internal rate of return on original equity		<b>14.99%</b>								
After tax return on original equity		<b>3.58%</b>	<b>4.10%</b>	<b>4.64%</b>	<b>5.18%</b>	<b>5.74%</b>	<b>6.31%</b>	<b>6.89%</b>	<b>211.73%</b>	
<b><u>Taxable income and tax distributions:</u></b>										
NOI from above		95,000	99,375	103,859	108,456	113,167	117,996	122,946	1,686,121	760,800
less interest expense or book value at sale		(35,070)	(33,829)	(32,541)	(31,204)	(29,816)	(28,375)	(26,879)	(1,162,271)	(217,714)
less depreciation - 39 years on 80% of cost		(27,839)	(27,839)	(27,839)	(27,839)	(27,839)	(27,839)	(27,839)		(194,872)
taxable income		32,091	37,707	43,479	49,413	55,512	61,783	68,229	523,850	348,215
Tax distributions at 40%/31% and 21% on sale		12,837	15,083	17,392	19,765	22,205	24,713	27,292	129,496	139,286

**ANNUAL BALANCE SHEETS**

	<u>Inception</u>								
Cash	0	14,574	31,277	50,156	71,257	94,630	120,324	148,390	1,010,426
Property at cost	1,357,143	1,357,143	1,357,143	1,357,143	1,357,143	1,357,143	1,357,143	1,357,143	
Accumulated depreciation	0	(27,839)	(55,678)	(83,516)	(111,355)	(139,194)	(167,033)	(194,872)	
Total assets	1,357,143	1,343,878	1,332,742	1,323,782	1,317,044	1,312,579	1,310,434	1,310,661	1,010,426
Debt	950,000	917,481	883,721	848,672	812,287	774,514	735,299	694,589	0
Original equity investment	407,143	407,143	407,143	407,143	407,143	407,143	407,143	407,143	407,143
Cummulative distributions	0	(12,837)	(27,919)	(45,311)	(65,076)	(87,281)	(111,994)	(139,286)	(268,782)
Accumulated earnings	0	32,091	69,798	113,278	162,691	218,203	279,986	348,215	872,065
Total liabilities and equity	1,357,143	1,343,878	1,332,742	1,323,782	1,317,044	1,312,579	1,310,434	1,310,661	1,010,426