



Your Property Needs – Lease or Own?

Georgia ***Commercial Board of Realtors***

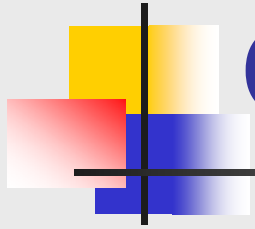
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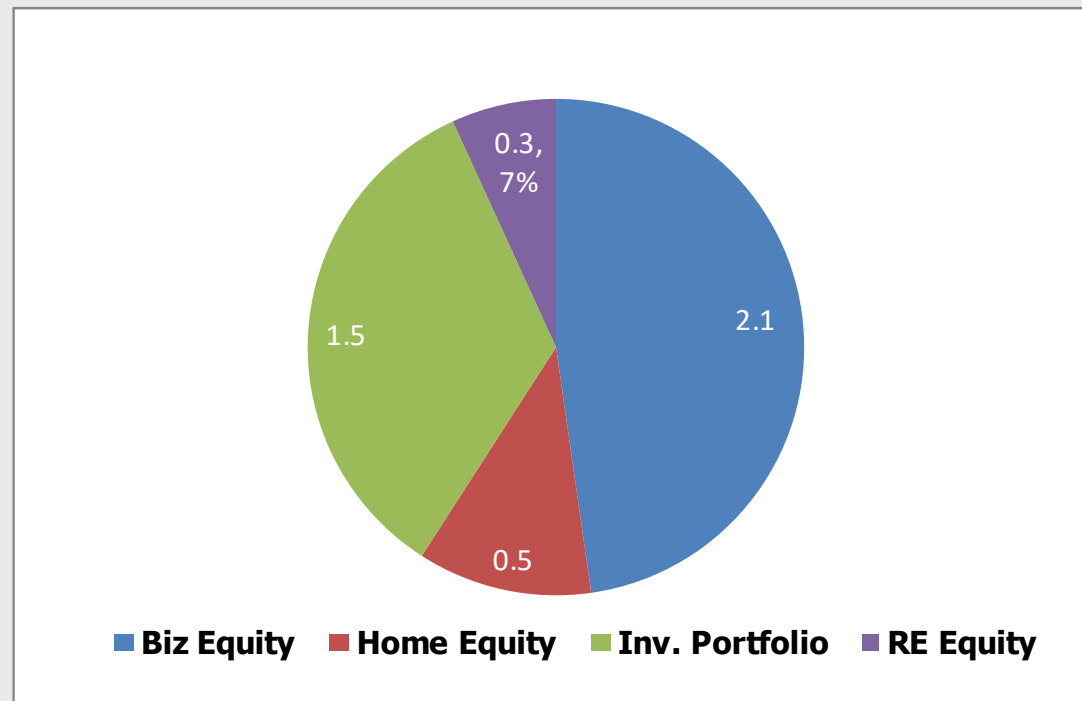
Jeff Olson, CPA



- CPA, Partner – Carr, Riggs & Ingram, LLC
- Real estate industry focus
 - financial reporting, taxation, consulting
- Work also with several Atlanta architects and engineers
- University of South Carolina
 - Undergraduate Accounting & Finance; Masters in Taxation



Owner's Balance Sheet





Debt and Real Estate Equity Returns

Positive "Leverage" effect

- **\$1,357,143 asset**
with a @ 7% annual return **95,000** (Net Operating Income)

- **Borrow 70% (\$950,000)**
@ 3.75% **67,589** (Annual Debt Service)
- **Annual Net Cash Flow** **27,411**

- **Annual pre-tax return on**
\$407,143 equity investment $27,411/407,143 = \underline{\underline{\mathbf{6.73\%}}}$



Debt and Real Estate Equity Returns

Positive "Leverage" effect

- **\$1,357,143 asset**
with a @ 8% annual return **108,571 (Net Operating Income)**

- **Borrow 70% (\$950,000)**
@ 3.75% 67,589 (Annual Debt Service)
- **Annual Net Cash Flow** 40,982

- **Annual pre-tax return on**
\$407,143 equity investment $40,982 / \$407,143 = \underline{\underline{10.07\%}}$



Debt and Real Estate Equity Returns

Negative "Leverage" effect

- **\$1,357,143 asset**
with a @ 6% annual return **81,429** (Net Operating Income)
- **Borrow 70% (\$950,000)**
@ 3.75% **67,589** (Annual Debt Service)
- **Annual Net Cash Flow** **13,840**
- **Annual pre-tax return on**
\$407,143 equity investment $13,840/407,143 = \underline{\underline{\mathbf{3.40\%}}}$



Economic Illustration

Hand out to be provided:

- 7 year period; inflation 2.5%.
- 10,000 sq. ft., cost of \$1.357 million (\$136/ft)
- \$407,143 equity; \$950,000 debt, 7 year term, 20 year amortization period, 3.75% fixed
- Annual rent \$17.50/ft, expenses \$8.00/ft
- Net operating cash flow = cash available to service debt = \$9.50/ft or 7% on cost (7% cap rate)



Summary Lease Vs. Own

- Pay rent expense for 7 years
- Or, own and occupy your own office for those 7 years
- Here are the results:

Lease vs own comparison:

	<u>Lease</u>	<u>Owner Occupied</u>	<u>Difference</u>
Initial investment	0	(407,143)	(407,143)
Cash expensed in operations, net of tax benefits	(818,757)	(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>	603,283
NPV, CF discounted at 6%	<u>(647,582)</u>	<u>(366,197)</u>	281,385
		Cash saved in operations	148,390
		Return on investment	454,894
		Total difference	<u>603,283</u>

Summary Comparison-

Also See Handout

Lease over 7 years:

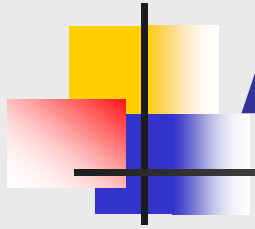
Rent paid	(1,364,595)
Tax deduction	545,838
Rent, net of tax, undiscounted	<u>(818,757)</u>
Discounted NPV at 6%	<u>(647,582)</u>

Owner over 7 years:

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

Summary Comparison-

Also See Handout



<u>Lease over 7 years:</u>		
Rent paid	(1,364,595)	
Tax deduction	545,838	
Rent, net of tax, undiscounted	(818,757)	
Discounted NPV at 6%	(647,582)	
	<i>Owner</i>	<i>Investor</i>
<u>Owner over 7 years:</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	(670,367)	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	454,894	454,894
Total undiscounted cash flow	(215,473)	603,283
Discounted NPV at 6%	(366,197)	281,385
Internal rate of return	N/A	14.99%



Options to a taxable sale?

- **If moving...**

- you likely need to get your equity out of the old building to buy a new one
- tax deferred Section 1031 exchange

- **If not needing to move...**

- refinance taking \$'s out tax free
- need to raise rent to cover higher debt service