nyrej

Monthly Q&A - Fortune 500 Wisdom

March 26, 2012 - Long Island

Q: We have a small manufacturing business and need to expand our facilities. We are debating whether to buy or lease or new facility. My broker tells us that most large corporate firms are leasing and not buying these days. Are there lessons to be learned from Fortune 500 companies, and does this mean that we should not purchase a building?

A: Yes, there are lessons to be learned from the largest companies in America when comes to managing your real estate. But the decision to buy or lease real estate may not be one of them. Fortune 500 Corporate America has indeed been divesting itself of real estate holdings, and, as a general rule, prefers to lease.

There are two major reasons for this trend. First is the inherent flexibility of leasing. We live in an age where corporate strategies, and therefore real estate needs are changing monthly (if not daily.) Leasing allows the acquisition of space with a minimum of investment, for a flexible time period, with an exit strategy that often can be defined in advance.

The second reason involves decisions regarding the best use of capital. If a large firm can invest its capital in its own business and achieve a 30% return, as an example, it would not want to invest in the "bricks and mortar" of real estate for, say, a 15% return. The firm is better off leasing and investing the capital in the business.

How does this apply to your situation? In preparing a buy-lease analysis for our clients, we compare the present-value cash flows for each real estate alternative to determine the total cost (in present value dollars) over a given time period, usually ten years. In a purchase scenario, we typically find that the break-even point for most small to medium size companies like yours is between five and seven years. This means, all other things being equal, if you plan to hold the facility for at least seven years, it would pay to purchase rather than lease your new facility. If you are a high-technology firm with changing needs for space, you are probably better off leasing. If your growth is stable, with a predictable need for space, a purchase may be indicated.

What about the return on capital investment? In most industrial real estate purchases on Long Island, a principal of the company purchases the building, and then leases it to the operating company. This is in contrast to Fortune 500 companies, where the operating company owns the real estate. Obviously, this is a personal investment decision that may need to involve your accountant. So you can see, the buy-lease scenario is highly personal, and there is no one right answer.

There is one lesson, however, to be taken to heart from corporate America. Large public companies have learned to concentrate on their core competencies, and outsource "commodity" services. So it is unusual to see large corporate real estate departments these days. Most of the tasks have been outsourced to professional real estate firms, often with employees of the vendor firm "embedded" within the organization of the hiring firm. Those real estate outsourcing services are also available to you, usually in the form of exclusive representation, for the analysis and acquisition of your new real estate project. This is a lesson from Fortune 500 America that you can take to heart.

David Hunt, MCR, CCIM, SIOR is the president of Hunt Corporate Services, Inc. and Hunt Construction Services, Inc., Plainview, N.Y.