

BUY versus LEASE EXAMPLE

INTRODUCTION

The Buy v Lease example analysis is for an office, industrial or retail property

This practice example consists of two Sections;

1. The input information for the project
2. The instructions for entering the project data

PROJECT INFORMATION

Property Name: Cedar Plaza
Description: Buy v Lease Analysis Example
Rentable Area: 3,000 Sq. Ft
Analysis Period: 10 Years
Starting Date: Year 1 Jan

INVESTOR INFORMATION

Landlord's Marginal Tax Rate: 36.00%
Discount Rate: Before Tax 13.00% Before Tax
Short Term Rates Before Tax for calculating the Modified Internal Rate of Return (MIRR)
Financing Rate: 8.000%
Reinvestment Rate: 3.000%

INVESTMENT

Land \$300,000
Building: \$550,000 Depreciation Method: Commercial Prop. St. Line

BUY (EXPENSES)

These are the operating costs associated with owning the building such as property taxes, insurance, maintenance etc.

For simplicity we will use the total operating costs, which included Taxes, Insurance and Maintenance as follows;

Rentable Area: 3,000 Sq Ft
Total Operating Costs: \$7.00 per Sq Ft per Yr paid monthly for 12 months then increasing at 3.00% compounding per year

LEASE (EXPENSES)

Cost of leasing instead of buying such as Base Rent, Additional Rent, Parking etc.

Rentable Area: 3,000 Sq Ft

Base Rent

\$17.00 per Sq. Ft per Yr paid monthly. Two terms of 5 years. Increase for the second term based on 3.00 % compounding for five years

Additional Rent

\$6.00 per Sq. Ft per Yr paid monthly for 12 months then increasing at 3.00% compounding per year for the remaining 9 years

Parking

12 spaces at \$30 per monthly for 12 months then increasing at 3.00% compounding per year for the remaining 9 years

FINANCING (BUY)

The financing to buy the property is;

Description: First Mortgage

Type: Standard Mortgage

Year 1. January 1, \$700,000 Time Period: 20 years, Amortization: 20 years, Interest Rate 7.50%

SALE INFORMATION

Real Estate Commission: 5.00% of the Sale Price

Selling Expenses: \$7,000

Sale Price based on the original investment increasing at 3.5% compounding per year

INSTRUCTIONS FOR ENTERING THE PROJECT INTO INVESTOR PRO

Getting started

The first step is to open the Investit Template "Buy v Lease" as follows:

1. Open investor Pro.
2. Select the New Project Folder then select the Investit Template folder
3. Select and open the Investit template "Buy v Lease" The analysis period dialog will open at this point.
4. Enter 10 years and click OK

Entering the project data and information

PROJECT INFO Folder

1. Enter the Property Name: Cedar Plaza
2. Enter the Description: Buy v Lease Analysis

INVESTOR Folder

1. Enter the Discount Rate Before Tax: 13.00%
Notes: The Discount Rate is used to calculate the Net Present Value and Net Effective Rent. The program automatically calculates the Discount Rate After Tax
2. Enter the Short Term Rate Before Tax Financing Rate: 8.00%
3. Enter the Reinvestment Rate: 3.00%

INVESTMENT Folder

First Row – Land

1. Enter the Amount: \$300,000

Second Row – Building

1. Enter the Description: Building
2. Enter the Amount: \$550,000
3. Select the Depreciation Method: Commercial Prop. St Line

Third Row

1. Press the  button

Fourth Row

1. Press the button

Your entries for the Investment folder should look like this;

Purchase Price and Capital Improvements						
<input type="button" value="Inflate"/>						
Description	Amount	Year	Month	Depreciation Method	Recovery Period [yrs]	
Land	\$ 300,000	Year 1	Jan	Land (No Deprec.)		
Building	\$ 550,000	Year 1	Jan	Commercial Prop. St Line	39.0	

BUY (EXPENSES) Folder

The Buy (Expenses) folder should appear like this

Description	Entry Choice	Qty	Year 1 Jan...	Year 1 Feb...
Property Taxes	Amount		\$ 0	\$ 0
Maintenance	Amount		\$ 0	\$ 0
Insurance	Amount		\$ 0	\$ 0
Utilities	Amount		\$ 0	\$ 0
Other Expenses	Amount		\$ 0	\$ 0

1. Select row 1
2. **Description column:** enter 'Operating Costs'
3. **Entry Choice column:** select '\$ per Sq. Ft per Yr'
4. Select row 2
5. Press the button
6. Select row 3
7. Press the button
8. Select row 4
9. Press the button
10. Select row 5
11. Press the button

Entering and Projecting the Operating Costs

Rentable Area: 3,000 Sq Ft

Total Operating Costs

\$7.00 per Sq Ft per Year paid monthly for 12 months then increasing at 3.00% compounding per year

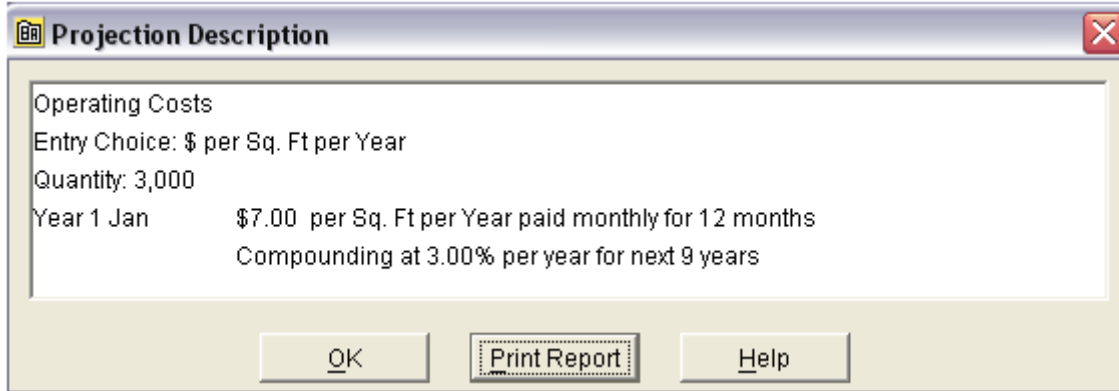
1. Select row 1 'Operating Costs'
2. Click on the button

In the **Projection Wizard** make the following entries;

3. **Paid column:** Select "Monthly for 12 Months"
4. **Project Entry Using column:** Select "Annual Compounding"
5. **Entry column:** Enter \$7.00

6. **Time Period column:** Check the "To End" box. This allows the projection to continue until the end of the 10 year Analysis Period
7. **Increase column:** Enter the Compounding Rate of 3.00%

To view your entries, click on the **Projection Description** button, which describes the entries and projections.



Your entries in the Projection Wizard should look like this;

Projection			Start Date		Time Period			Increase
Paid	Project Entry Using...	Entry	Year	Month	To End	Yrs	Mos	Increase
Monthly for 12 Months	Annual Compounding	\$ 7.00	Year 1	Jan	<input checked="" type="checkbox"/>	10	0	3.00%

Press OK to return to the Buy (Expenses) folder

LEASE (EXPENSES)

The Lease (Expenses) folder should appear like this;

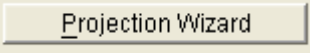
Revenue					
Description	Entry Choice	Qty	Year 1 Jan...	Year 1 Feb...	
Basic Rent	\$ per Sq. Ft per Yr	0	\$ 0.00	\$ 0.00	
Additional Rent	\$ per Sq. Ft per Yr	0	\$ 0.00	\$ 0.00	
Parking	\$ per Space per Mo	0	\$ 0.00	\$ 0.00	

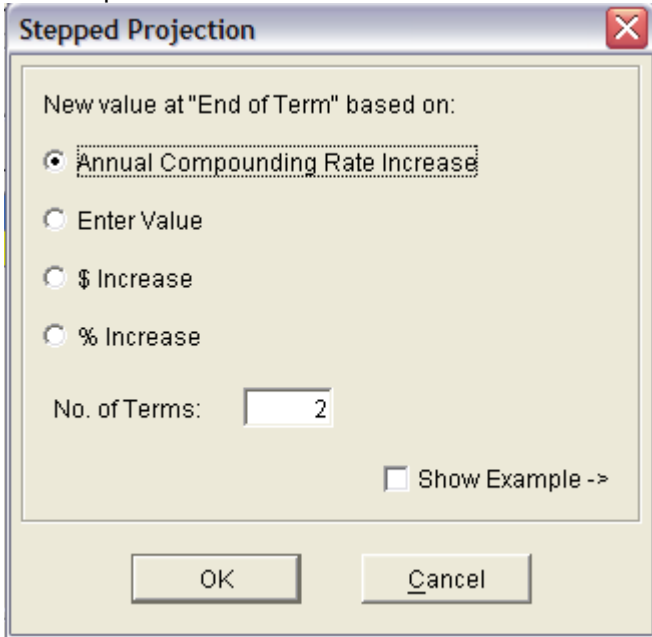
1. Select row 1
2. Enter Description: Base Rent
Note: Default entry is Basic Rent
3. Enter QTY: 3,000
4. Select row 2
5. Enter QTY: 3,000
6. Select row 3
7. Enter Qty: 12

Entering and Projecting the Base Rent

Base Rent

\$17.00 per Sq. Ft per Yr paid monthly. Two terms of 5 years. Increase for the second term based on 3.00 % compounding for five years

1. Select row 1 'Base Rent'
2. Click on the  button
3. In the **Projection Wizard** make the following entries;
4. **Project Entry Using column:** Select "Stepped Proj. (Lease)" and set the number of terms to 2 and press OK



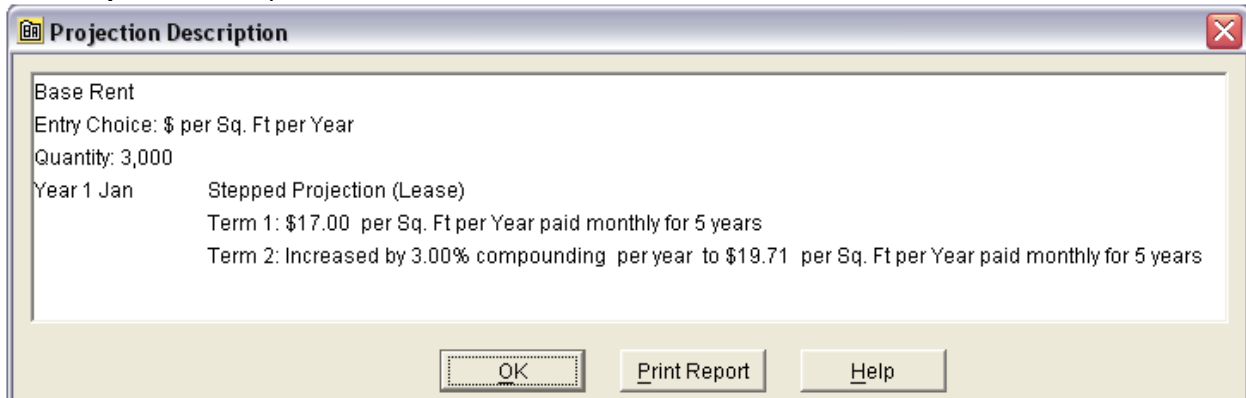
5. **Entry Column:** Enter \$17.00
6. **Time Period column:** Change term 1 Yrs to '5'
7. **Increase column:** Enter the Compounding Rate of 3.00%

Row 2

8. **Time Period column:** select "To End"

To view your entries, click on the  button, which describes the entries and projections.

Your Projection Description should look like this;



Press OK to return to the Projection Wizard

Your entries in the Projection Wizard should look like this;


Projection									
				Start Date		Time Period			
Paid	Project Entry Using...	Entry	Term	Year	Month	To End	Yrs	Mos	Increase
Monthly	Stepped Proj. (Lease)	\$ 17.00	1	Year 1	Jan		5	0	3.00%
			2	Year 6	Jan	<input checked="" type="checkbox"/>	5	0	

Click OK to return to the Lease (Expenses) folder

Entering the Additional Rent

Additional Rent

\$6.00 per Sq. Ft per Yr paid monthly for 12 months then increasing at 3.00% compounding per year for the remaining 9 years

1. Select row 2 'Additional Rent'
2. Click on the  button
3. In the **Projection Wizard** make the following entries;
4. **Paid column:** Select "Monthly for 12 Months"
5. **Project Entry Using column:** Select "Annual Compounding"
6. **Entry Column:** Enter \$6.00
7. **Time Period column:** Check the "To End" box. This allows the projection to continue until the end of the 10 year Analysis Period
8. **Increase column:** Enter the Compounding Rate of 3.00%

Your entries in the Projection Wizard should look like this;


Projection									
				Start Date		Time Period			
Paid	Project Entry Using...	Entry	Year	Month	To End	Yrs	Mos	Increase	
Monthly for 12 Months	Annual Compounding	\$ 6.00	Year 1	Jan	<input checked="" type="checkbox"/>	10	0	3.00%	

Press OK to return to the Lease (Expenses) folder

Entering the Parking

Parking

12 spaces at \$30 per month for 12 months then increasing at 3.00% compounding per year for the remaining 9 years

1. Select row 3 'Parking'
2. Click on the  button
3. In the **Projection Wizard** make the following entries;
4. **Paid column:** Select "Monthly for 12 Months"
5. **Project Entry Using column:** Select "Annual Compounding"
6. **Entry Column:** Enter \$30.00

7. **Time Period column:** Check the "To End" box. This allows the projection to continue until the end of the 10 year Analysis Period
8. **Increase column:** Enter the Compounding Rate of 3.00%

Your entries in the Projection Wizard should look like this;

Projection									
			Start Date		Time Period				
Paid	Project Entry Using...	Entry	Year	Month	To End	Yrs	Mos	Increase	
Monthly for 12 Months	Annual Compounding	\$ 30.00	Year 1	Jan	<input checked="" type="checkbox"/>	10	0	3.00%	

Press Ok to return to the Lease (Expenses) folder

Select the Financing (Buy) folder

FINANCING (BUY)

Description: First Mortgage

Type: Standard Mortgage

Year 1. January 1, \$700,000 Time Period: 20 years , Amortization: 20 years, Interest Rate 7.50%

Setting up a mortgage

1. Click on the Add Mortgage button

Add Mortgage	Edit Mortgage	Delete Mortgage	Move
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2. Amount box: \$700,000
3. Description box: "First Mortgage"
4. Time Period box: 20 Years
5. Amortization box: 20 Years
6. Nominal Interest Rate box: 7.50%

The mortgage dialog should look like this;

Mortgage

Mortgage Details
 Analysis Period: Year 1 Jan to Year 10 Dec
 Commencing Year 1 Month January
 Type Standard Mortgage
 Amount \$ 700,000 Interest Rate Fixed
 Description First Mortgage

Mortgage Settings
 Payment Frequency Monthly
 Additional Payments/Borrowing
 Payment Rounded Up to Nearest Cent
 Compounding Frequency Monthly

Terms and Amortization Details
 No of (Balloon) Terms 1

Term No	Time Period		Amortization		Nominal Interest Rate
	Years	Months	Years	Months	
1	20	0	20	0	7.500%

Buttons: OK, Compute, Fill Down, Cancel, Help, Comments

7. Press the **Compute** button
8. Press the OK button

The Financing Folder should now look like this;

Mortgage (Borrowing)

Description	Type	Amount	Start Date
First Mortgage	Standard Mortgage	\$ 700,000	Year 1 Jan

Buttons: Add Mortgage, Edit Mortgage, Delete Mortgage, Move

Select the Sale folder

SALE Folder

Real Estate Commission: 5.00% of the Sale Price

The Real Estate Commission should appear like this;

Real Estate Commission

Fixed Percentage of Sale Price

0.00%

Entering the Real Estate Commission

1. Enter 5.00% in the appropriate box

The Real Estate Commission should now look like this;

Real Estate Commission

Fixed Percentage of Sale Price

5.00%

Selling Expenses: \$7,000

The Selling Expenses should appear like this;

Selling Expenses

Description	Entry Choice	Expense
Selling Expenses	Amount	\$ 0

Add Insert Delete Move

1. Enter in the Expense column: \$7,000

The Selling Expenses should now look like this;

Selling Expenses

Description	Entry Choice	Expense
Selling Expenses	Amount	\$ 7,000

Add Insert Delete Move


Sale Price based on the original investment increasing at 3.5% compounding per year

The Sale Price Estimator should appear like this;

Sale Price Estimator

Sale Price Wizard

\$ 0

1. Press the  button

The Sale Price Wizard dialog will pop up;

Sale Price Wizard

Compound Annual Growth Rate Enter Your Own Estimation

Uniform Annual Increase

2. Compound Annual Growth Rate: 3.5%
 3. Select Compound Annual Growth rate by clicking on the selection box next to the figure that appeared next to your entry
- Note: The correct entry field has been circled in red

The Sale Price Wizard should now look like this;

Sale Price Wizard

Compound Annual Growth Rate Enter Your Own Estimation

Uniform Annual Increase

Press OK to return to the Sale folder

The Sale Price Estimator should now look like this;

Sale Price Estimator

Sale Price Wizard