**Raising Your Commercial IQ**

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**203 Office, Industrial and Retail Leasing**

**In-house Training Program**

**Participant Package**

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# Calculator

You will need to bring a calculator. In can be any kind of calculator. It doesn’t have to be a financial calculator.

# Skills and benefits obtained from the in-house sessions

To provide a comprehensive understanding of:

The leasing process and terms used in leasing

How to read a lease and what to look for in a lease

The differences between the different kinds of leasing markets

How tenants go about choosing a location and space

What question to ask the landlord and tenant

Some of the complex issues involved leases and lease negotiations

Why leases are often complex, lengthy documents

How to carry out lease comparison analysis from a landlord & tenant perspective

Topics

Following is a summary of topics that will be covered.

Overview of landlord and tenant leasing objectives

Tenant compatibility considerations and issues

Leasing characteristics by different types of properties

The leasing process and documents

Types of Leases

Gross & Modified Gross Leases, Indexed lease, Triple Net Lease Expense Caps and Stops and Rent Caps

Types of Rent

Base Rent & Additional Rent or Recoverable Expenses

Free Rent

Percentage Rent

Areas and Area Measurement

Rentable and Usable Areas and Load Factor

Space Measurements and the BOMA Standards

How to measure different types of properties

Issues related to measuring space

Leasing new space. Tenant Improvements and build outs.

Assignment & Subletting

Operating Expenses, Recoverable Expenses and related issues and considerations

Renovating and subdividing space including structural considerations

Lease Comparison Analysis and the Net Effective Rent from landlord & tenant perspective

Case Study. Comparing three different lease arrangements

Valuing ground leases.

Blending and extending a lease

Impact of leases on the property value and marketability

Tips for reading leases

Leasing as a career

Skills and benefits obtained from the video

Increased knowledge of lease terms and the leasing process

The differences involved in leasing office, industrial and retail space

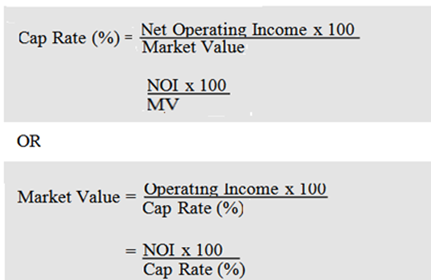
A deeper understanding of the complex issues related to leasing

How to compare leases from a landlord or tenant perspective

The knowledge and skills developed during the video will improve your ability to negotiate and analyze leases and put leasing deal together from a tenant or landlord perspective.

# FORMULAS USED IN LEASE ANALYSIS

**Cap Rate (Capitalization Rate)**



**Net Effective Rent (NER)**

Net Effective Rent (NER) = Net Present Value at X%

Area x No. of Years

Example:

Net Present Value at 10%: $4,500,000

Rentable Area: 20,000 Sq. Ft

Lease period: 10 years

Net Effective Rent (NER) = Net Present Value at 10%

Area x No. of Years

= $4,500,000

$20,000 x 10 years

= $22.50 per Sq. Ft per Yr at 10%

# AGENDA TIME TABLE

**Landlord & Tenants**

|  |  |  |  |  |
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| 2 | Leases and Property Types (14 min) | 7 |  |  |
| 3 | The leasing process (7 min) | 9 |  |  |
| 4 | Types of Leases (8 min) | 13 |  |  |
| 5 | Types of Rent (8 min) | 14 |  |  |
| 6 | Term of The Lease (7 min) | 25 |  |  |
| 7 | Assignment & Subletting  (2 min) | 27 |  |  |
| 8 |  |  | Landlord and Tenants | 9 |
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| 22 |  |  | Operating and Recoverable Expenses | 39 |
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| 24 | Analyzing leases (1 min) |  |  |  |
| 25 | Net Effective Rent (NER) (2 min) |  |  |  |
| 26 | Comparing Leases. Case study (5 min) |  |  |  |
| 27 | Lease negotiations.  The trade offs (4 min) |  |  |  |
| 28 | Lease negotiations. Case study (13) |  |  |  |
| 29 | Valuing Ground Lease (2 min) |  |  |  |
| 30 | Blending & Extending a Lease (8 min) |  |  |  |
| 31 | Lease. Impact on value & marketability (4 min) |  |  |  |
| 32 | Mutually exclusive investment analysis & Buy versus Lease Analysis (4 min) |  |  |  |
| 33 | Buying versus renting a home.  Case study (8 min) |  |  |  |
| 34 | Buy versus lease office space. Case study (9 min) |  |  |  |
| 35 | Analyzing a multi-lease proposal 3 min) |  |  |  |
| 36 | Tips for reading a lease (3 min) |  |  |  |
| 37 | Demolition clauses (3min) |  |  |  |
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| --- | --- | --- | --- | --- |
| **Line**  **number** | **Play Micro Video** | **Manual**  **Page Number** | **Play Flash Card Set** | **Participant Package**  **Page number** |
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**PRACTICE QUIZ and 203 COURSE EXAM**

Suggest the participants take the **203 Practice Quiz** to test their knowledge and measure their progress.

They can take the test many times, and the grade will be recorded and can be reviewed.

The quiz results are confidential and cannot be viewed by anyone else.

**203. Course Exam.**

Take the 203 course exam which is set up by a manager or office administrator.

# FLASH CARDS. QUESTIONS

# Landlord and Tenant

**Q1.**

In legal terms the:

Landlord is called the \_\_\_\_\_\_\_\_\_\_\_

Tenant is called the \_\_\_\_\_\_\_\_\_\_\_

**Q2.**

Be very careful when working with inexperienced landlords, tenants or realtors because there is a potential for misunderstandings.

Write down some examples of potential misunderstanding between the landlord, tenant and inexperience realtor.

***Your answer***

**Q3.**

Write down some of the landlord’s major concerns when leasing space to a tenant.

***Your answer***

**Q4.**

List some of the concerns that a tenant may have when leasing space.

***Your answer***

**Q5.**

Landlords and Tenants are often concerned with “Tenant Mix & Compatibility” in property.

Provide an example of poor tenant mix for a small retail strip center with limited onsite parking for 6 cars. The adjacent street a parking is metered and it is often hard to find a parking spot**.**

***Your answer***

**Q6.**

Explain ‘Synergy” as it relates to real estate and provide several examples.

Synergy means that the “whole” is greater than the sum of the individual “Parts” or 2+2 = 5 and has wide application for real estate establishments**.**

***Your answer***

**Q7.**

An industrial tenant with heavy equipment is considering renting 25,000 sq. Ft of industrial rent.

Besides the rent what are some features and building attributes that will be of concern to the industrial tenant?

***Your answer***

*Note. In the “Resources” section of the Investit Academy LMS there is an extensive ‘Industrial Real Estate Check List” Take a look.*

**END**

# The Leasing Process

**Q1.**

Is there a standard way to calculate a leasing fee?

***Your answer***

**Q2.**

What are some of the ways that leasing commissions are calculated?

***Your answer***

**Q3.**

Leasing agreements often include the right for the tenant to renew the lease. Does the landlord have to pay a leasing fee on the renewal of the lease?

***Your answer***

**Q4.**

A “Triple Net Lease (NNN) consists of the “Base Rent” and the “Additional Rent” which is the payment of the landlord’s operating expenses such as “Taxes, Insurance & Maintenance” as spelled out in the lease.

Does the leasing commission calculation include the “Additional Rent”?

***Your answer***

**Q5.**

The “Commission Agreement” or “Authority to Lease” must include;

1. How the leasing commission is calculated
2. How it will be paid
3. When will it be paid

Why is the third item “When will it be paid?” so important?

***Your answer***

**Q6.**

Is a leasing commission always paid as a single amount or can the fee payment be spread over time?

***Your answer***

**Q7.**

What are the three main documents that are used when leasing space?

***Your answer***

**Q8.**

The ‘Letter of Intent (LOI)” is an enforceable contract

**True or False**

***Circle your answer***

**Q9.**

What’s the purpose of the “Offer to Lease” or “Agreement to Lease”?

**Q10.**

Is an accepted “Offer to Lease” a binding contract?

YES \_\_\_\_\_ NO \_\_\_\_\_

**Q11.**

List some of the approvals that may be required by the City before the space can be occupied.

***Your answer***

**END**

# Types of Leases

**Q1.**

What is a “Gross Lease” and a “Full Service Lease”?

***Your answer***

**Q2.**

What’s the disadvantage of a Gross Lease from a landlord’s perspective?

***Your answer***

**Q3**

What’s a Modified Gross Lease?

***Your answer***

**Q4.**

What is an Indexed Lease or a Gross lease with an escalation clause?

***Your answer***

**Q5.**

What’s a Triple Net Lease (NNN)? Also called a Net Lease.

***Your answer***

**Q6.**

How clear and specific are terms like:

1. Gross Lease
2. Modified Gross Lease
3. Indexed lease
4. Full Service Lease
5. Triple Net Lease (NNN)

***Your answer***

**Q7.**

Are the different types of leases like “Full Service Lease” and “Triple Net” used consistently based on the type of real estate and are they independent of the geographic location of the real estate?

As an example, full service leases are often used for office buildings but is this consistent across the country?

How about rent rates such as $ per Sq. Ft per Yr versus $ per Sq. Ft per Mth?

***Your answer***

**END**

# Types of Rent

**Q1.**

What is the Base Rent?

***Your answer***

**Q2.**

What is the “Additional Rent”?

***Your answer***

**Q3**

What is “Free Rent”?

***Your answer***

**Q4**

Does “Free Rent” apply to “Additional Rent?”

***Your answer***

**END**

# Percentage Rents

**Q1.**

Explain “Percentage Rent”

***Your answer***

**Q2.**

Why do retail landlords use a “Percentage Rent”?

***Your answer***

**Q3.**

What types of retail establishments use a “Percentage Rent”?

***Your answer***

**Q4.**

In calculating the “Percentage rent” what is the difference between the “Natural Break Point” and the “Artificial Breakpoint (Unnatural Breakpoint)”?

***Your answer***

**Q5.**

Based on the following information calculate:

1) The tenants annual rent

2) The “Natural Break Point”

Base Rent: $300,000 per year (Minimum rent)

Percentage Rent: 3.00%

Gross Business sales; $15,000,000

Your answer

1. Annual rent calculation
2. Natural Breakpoint

**END**

# Expense Caps and Stops

**Q1.**

What is an “Expense Stop”?

***Your answer***

**Q2.**

Explain an Expense Stop coupled with “Base Year” operating expenses.

***Your answer***

**Q3.**

Explain an Expense Cap and provide an example

***Your answer***

**END**

# Lease Term, Option to Renew and Bumps and Steps

**Q1.**

**Wh**at is the “Lease Term”?

***Your answer***

**Q2.**

What is a “Periodic Tenancy”?

***Your Answer***

**Q3.**

What is an “Option to Renew?” and how is the renewal rate determined?

***Your answer***

**Q4.**

A tenant is entering into a Five Year term lease that has a renewal option for another five years.

The renewal rate will be based on the “Fair Market” rent at that time.

The tenant is really concerned about how high the rent will be when the lease is renewed.

Can the renewal rent rate be limited?

***Your answer***

**Q5.**

Show me an example of a Rent Cap in action.

***Your answer***

**Q6.**

What do lease “Bumps and Steps” refer to?

***Your answer***

**Q7.**

How is the “Fair Market Rent” established?

*Yo****ur answer***

**Q8.**

What if the landlord and the tenant can’t agree on the free market rent?

***Your answer***

**END**

# Assignment and Sub Leasing

**Q1.**

What is an assignment of a lease?

***Your answer***

**Q2.**

What is a “Sublease”?

***Your answer***

**Q3.**

Landlords hate this. A tenant profiting from a sublease.

Explain how a tenant can profit from a sublease

***Your answer***

**Q4.**

How can the landlord profit from a tenant subleasing at a higher rent rate than the lease rate?

***Your answer***

**Q5.**

Can a tenant always “sublet” or “Assign” the lease to a third party?

***Your answer***

**END**

# How to define and measure Space

**Q1.**

What are the Rentable Area and the Gross Leasable Area (GLA)?

***Your answer***

**Q2.**

How do you calculate the rentable area in an office building?

***Your answer***

**Q3.**

Calculate the Base Rent per month for an office building using the following information:

Base Rent: $25 per Sq. Ft per Yr. based on the “Rentable Area”

Usable Area: 15,000 Sq. Ft. This is the area occupied by the tenant.

Add on Factor: 14%

***Your answer***

**Q4**

What are the BOMA standards?

*Your answer*

**Q5.**

When using the BOMA Standard to measure space in an office building the stair well and elevator shaft are included in calculating the tenant’s rentable area.

True or False

***Circle your answer***

**Q6.**

Using the BOMA Standards for office buildings how would you measure Tenants A’s space?

*Circle or tick your answers*

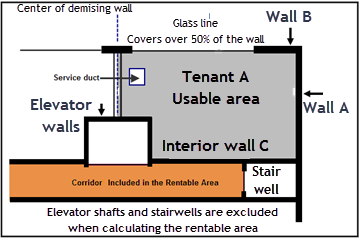
WALL A. Measure to *Inside*  OR to the *Outside*  of the wall

WALL B. Over 50% of the wall is glass. Measure to *Inside*  OR the *Outside*  of wall B or to the *Inside*  of the glass line?

INTERIOR C. Measure to the *Inside*  or *Exterior*  of the interior wall?

DEMISING WALL. Measure to the *Interior* or the *Middle*  of the demising wall?

ELEVATOR WALLS. Measure to the *Inside*  or Exterior of the elevator walls?



**Q7.**

What are the dangers associated with quoting rents as $ per Sq. Ft per Yr. or Month?

***Your answer***

**Q8.**

What’s the simple solution to the problems created by quoting rent as $ per sq. Ft per Yr. or Month

***Your answer***

**END**

# Renting Space from plans

**Q1.**

When leasing space from plans or in a building that’s under construction what are some of the “unknowns” that have to be dealt with in the “Offer to Lease or the Lease”

***Your answer***

**Q2.**

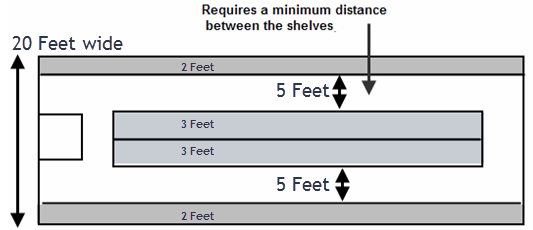
Since the rentable area is not known until the space is complete how can this uncertainty be handled in the “Offer to Lease”

***Your answer***

**Q3.**

A retailer who is considering renting space in a building that is under construction

requires a minimum of two aisles with a minimum width of 5 feet to accommodate two shopping carts side by side as illustrated below.

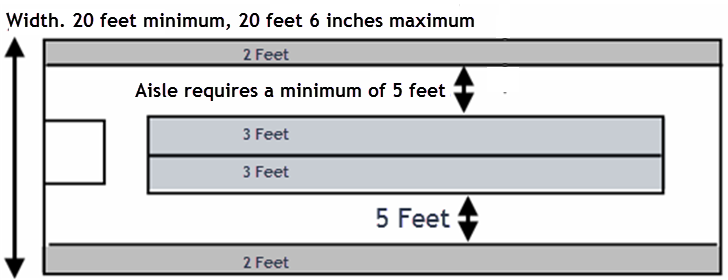


Since the final width cannot be determined until the construction is complete how would you specify the tenant’s requirements in the “Offer to Lease”?

***Your answer***

**Q4.**

What’s the financial impact on the tenant if the tenant’s space ended up being 19 feet wide instead of the desired 20 feet?



***Your answer***

**Q5.**

The length or depth of the retail space can be very important. Case study.

A retailer has rented space from the plans. The display cases come in 10 feet modules. He needs 6 display cases which means the depth needs to be a minimum of sixty feet deep.

The space he rented was supposed to be 20 feet wide by a minimum of 60 feet deep.

Let’s see what happened when the space was finished and the tenant was ready to move it

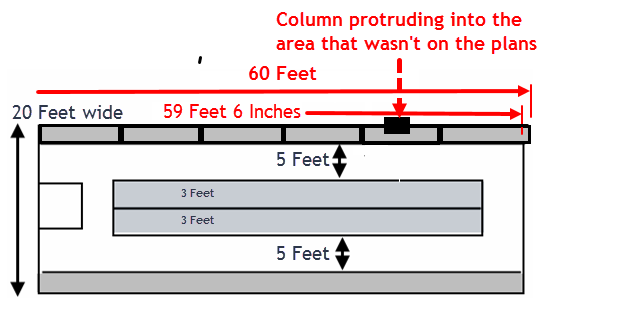
***Flip side***

Problems.

1. Depth was 59 feet 6 inches which means the last display case doesn’t fit as 60 feet is needed
2. A concrete column that wasn’t shown on the plans is protruding into the space.

The result is that the tenant has to get three display cases special made which was very costly.

The tenant sued the landlord for the extra display case costs.



**END**

# Tenant Improvements (TI’s)

**Q1.**

What are leasehold improvements?

Also called “Tenant Improvements (TI’s) or “Buildouts”

***Your answer***

**Q2.**

Who builds the “Leasehold Improvements”?

***Your answer***

**Q3.**

What are leasehold specifications and plans?

***Your answer***

**Q4**

Why are “Leasehold Improvements” specifications and plans so important?

***Your answer***

**Q5**

Who pays for the “Leasehold Improvements”?

***Your answer***

**Q6.**

What is a “Shell Lease”?

***Your answer***

**Q7.**

What is a “Turnkey” lease?

***Your answer***

**Q8.**

What’s a Shell Lease with an allowance. Landlord builds?

***Your answer***

**Q9.**

What’s a Shell Lease with an allowance. Tenant builds?

***Your answer***

**Q10.**

Why is it important to have the landlord quote the leasehold improvement allowance as a dollar amount rather than a $ per Sq. Ft? E.g. $300,000 versus $150 per Sq. Ft

***Your answer***

**Q11.**

What is a “Build to Suit” single tenancy building?

***Your answer***

**Q12.**

With leasehold improvements being provided by the landlord or build to suit arrangements what do you think are the two major problems that need to be dealt with in the lease?

***Your answer***

**Q13.**

The landlord agrees to build $400,000 worth of leasehold improvements based on the agreed upon detailed specifications prepared by the tenant’s engineers and architects.

During the construction the tenant decides to upgrade the carpets, add more costly lighting fixtures and two more offices adding $320,000 of additional costs.

How does the landlord get reimbursed for the additional leasehold improvement costs of $320,000?

***Your answer***

**Q14**

What is “Force Majeure”?

***Your answer***

**END**

# Missing the Occupancy Date

**Q1.**

When leasing space from plans or in a partially constructed building the completion and occupancy date is not known for certain.

Can you come up with some examples of when a missed occupancy date would be very costly for the tenant in terms of lost revenue?

In other words if the space is not ready to move in by the date specified in the lease the tenant would lose a lot of sales revenue

***Your Answer***

**Q2.**

A tenant is moving into a new facility on July 1. The lease specified that the space would be ready June 1. The following has taken place

1. The tenant has given notice to their landlord and has to move out by June 30.
2. The landlord has rented the space commencing July 1

What happens if the new space is not available July 1?

***Your Answer***

**END**

# Operating and Recoverable Expenses

**Q1.**

If a lease uses the term “Recoverable Expenses” what are Recoverable Expenses?

***Your answer***

**Q2.**

Which of the following would not be considered an operating expense and a recoverable expense?

Property taxes

Replacement of the boiler

Insurance

Cleaning services

Major upgrade to the elevator

Fee for leasing vacant space

***Circle your answer***

**Q3.**

What other names are used for “Recoverable Expenses”

***Your answer***

**Q4.**

A lease will often state the tenant is not responsible for structural repairs.

Write down two examples of structural repairs.

***Your answer***

**Q5.**

What does “Grossing Up” of operating expenses mean?

***Your answer***

**Q6.**

Who pays the operating expenses on the vacant space?

***Your answer***

**Q7.**

How does a lease handle the recoverable operating cost that is caused by a particular tenant who is receiving a specific benefit?

Provide an example.

***Your answer***

**END**

# Renovating and Subdividing Space

**Q1.**

Vertical loads in a building can be broken down in two types of loads.

What are the names of the two types of vertical loads and provide an example of each?

***Your answer***

**Q2.**

Provide two examples of “Horizontal Loads” that can impact a building

***Your answer***

**Q3.**

What’s the purpose of the shear system in a building?

Give two examples of a “shear System” in a building

***Your answer***

**Q4.**

Why should you never make statement that a wall can be removed even if the wall appears to be a non-load bearing wall?

***Your answer***

**Q5.**

If you are considering subdividing space why should you recommend to the landlord to check with an architect or the city before subdividing the space?

***Your answer***

**END**

# Lease Comparison Analysis

**Q1.**

When carrying out lease comparison analysis why do we use discounted cash flow analysis and calculate the Net Present Value of the lease and the Net Effective Rent?

***Your answer***

**Q2.**

A landlord has 10,000 Sq. Ft for rent and has received the following offers from Tenant A and Tenant B. Which one is the best deal based on the Net Effective Rent (NER) at 10%?

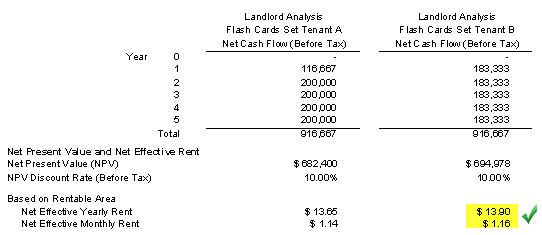
Tenant A. $20 per Sq. Ft per year for five years with free rent for the first five months of year 1. Tenant A has made this proposal because they want to reduce their expenses in the first year because it is a start-up business.

Tenant B. $20 per Sq. Ft per year for five years with one month of free rent every year for five years.

In both cases the tenant will pay the additional rent to cover the taxes, insurance and maintenance (TIM’s).

***Flip Side***

The following compares the cash flow the landlord will receive and the Net Effective Rent at 10%



The best deal for the landlord is Tenant B’s proposal which has a Net Effective Rent at 10% of $113.90 per Sq. Ft per year compared to $13.65 per Sq. Ft per year for Tenant A even though the total amount received over the five years of $916,667 is the same for both proposals.

**Q3.**

When comparing leases using the discounted cash flow approach why can’t you calculate the Internal Rate of Return (IRR)?

***Your answer***

**Q4.**

When carrying out lease comparison analysis why is important to compare the leases over the same time period?

***Your answer***

**Q5.**

Calculate the Effective Rent (NER) using:

Net Present Value at 10%: $4,500,000

Rentable Area: 20,000 Sq. Ft

Lease period: 10 years

***Your answer***

**Q6.**

Is the Net Effective Rent (NER) helpful when analyzing one lease?

***Your answer***

**Q7**

When comparing leases using the Net Present Value (NPV) and the Net Effective Rent (NER) how important is the selection of the “Discount Rate”?

***Your answer***

**Q8.**

You are considering renting space in an office building and there are two buildings with space available in the location you desire. The rent rates are:

Space A. Usable area: 1,500 Sq. Ft. Base Rent Rate: $25 per Sq. Ft per Yr of rentable area

Space B. Usable area: 1,500 Sq. Ft. Base Rent Rate: $27 per Sq. Ft per Yr of rentable area

Why is it incorrect to select Space A as the best deal because it has the lowest rent?

***Flip side***

It’s incorrect to choose to rent based simply on the first year base rent rate as there are a lot of factors beyond the rent rate to consider such as different “Gross Up factors”, differences in the “Additional Rent” and parking expenses as illustrated below.

**Example**

|  |  |  |
| --- | --- | --- |
|  | **Space A** | **Space B** |
| **Rent Rate using Rentable Area** | **$25 per Sq. Ft per Yr** | **$27 per Sq. Ft per Yr** |
| **Usable Area** | **1,500 Sq. Ft** | **1,500 Sq. Ft** |
| **Add on Factors Gross Up factor** | **16%** | **13%** |
| **Rentable Area** | **1,740 Sq. Ft** | **1,695 Sq. Ft** |
| **Term** | **Five years** | **Five years** |
| **Additional Rent** | **$9.00 per Sq. Ft per Yr** | **$6.00 per Sq. Ft per Yr** |
| **Parking. Seven cars** | **$75 per month per space** | **Free** |

To correctly compare these two leases from the tenant’s perspective you need to:

1. Calculate the total annual leasing expenses for each of the five years
2. Calculate and compare the Net Present Value and the Net Effective Rent over the five years
3. See next flash card for results

**Q9.**

A tenant is considering two spaces for renting two different buildings.

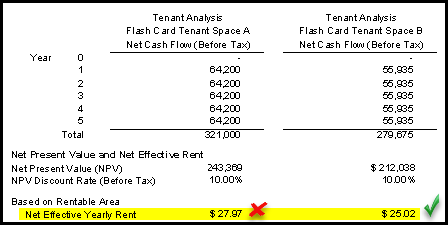
Which space is the best deal from the Tenant’s perspective?



***Flip side***

Even though the rent for Space A is $25 per sq. Ft per Yr which is less than Space B at $27 per Sq. Ft per Yr. Space B is the best deal when all the factors such as the Gross Up factors, differences in the “Additional Rent” and parking expenses are taken into account over the five years.

The Net Effective Rent (NER) at 10% is for Space A is $27.97 and $25.02 for Space B. From a financial viewpoint Space B with the higher base rent of $27 per Sq. Ft per Yr. compared to $25 for Space A is the best deal.



**Q10**

What information do you need to calculate the Net Effective Rent (NER) from a landlord and tenant perspective?

***Your answer***

**END**

# Lease negotiations. Landlord Tenant Trade Offs

**Q1.**

When negotiating a lease there are a number of trade-offs that can be made between the landlord and tenant.

List as many of the trade-offs as you can.

***Your answer***

**Q2.**

Provide a simple example of a trade-off that can be made between the landlord and the tenant so that the Net Effective Rent (NER) remains the same.

***Your answer***

Q3.

List two of the primary goals of the landlord when negotiating a lease

***Your answer***

**Q4.**

Why is maintaining the rent as high as possible so important to the Landlord?

If the landlord can increase from $21 to $23 per Sq. Ft per Yr how much will the value increase if the Cap Rate is 5.00% and the rentable area is 25,000 Sq. Ft?

***Your answer***

**END**

# Valuing a Land Lease

**Q1.**

What is a ground Lease and provide an example?

***Your answer***

**Q2.**

With a ground lease does the building developer end up owning the land at the end of the land lease?

**Yes or No**

***Circle your answer***

**Q3.**

Can a ground or land leases be bought and sold?

Yes or No

***Circle your answer***

**Q4.**

How do you go about valuing a ground or land lease?

***Your answer***

**Q5.**

Example. Calculating the value of a ground or land lease

An investor is considering buying a land lease and wants a 10% return.

The land lease is $200,000 per year for 75 years. The yearly lease payments are made at the beginning of each year.

How much should the investor pay for the land lease?

***Flip side***

**The Net Present Value (NPV) $200,000 per year for 75 years at 10% discount rate is $2,198,270 with the annuals lease payment being made at the beginning of the year.**

**The value of the ground lease at 10% is $2,198,270**

**If an investor bought the ground lease for $2,198,270 the return (IRR) would be 10%**

**\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_**

**END**

# Blending & Extending a Lease

**Q1.**

Explain “Blending & Extending” a lease

***Your answer***

**Q2.**

Provide an example of blending and extending a lease.

***Your Answer***

**END**

# Buy Versus Lease Analysis

**Q1**

What are “Mutually **Exclusive Investments”**

***Your Answer***

**Q2.**

How do you carry out “Buy versus Lease Analysis”?

***Flip Side***

To carry out “Buy versus Lease Analysis:

1. Develop the “Net cash flow” for the “Buy” option (After tax)
2. Develop the “Net cash flow” for the “Lease” Option (After tax)
3. Calculate “Net Cash Flow Buy – Net Cash Flow Lease” (After tax)
4. Calculate the Internal Rate of Return (IRR) and Net Present Value (NPV) after tax
5. Is the Return on Investment (IRR) of buying compared to leasing acceptable? If not consider leasing.

This is called the “Differential” or ‘Incremental Cash Flow” analysis and is a very important concept for analyzing mutually exclusive investments such as “Buy versus Lease”

**Q3.**

Why should Buy versus Lease analysis be done after tax?

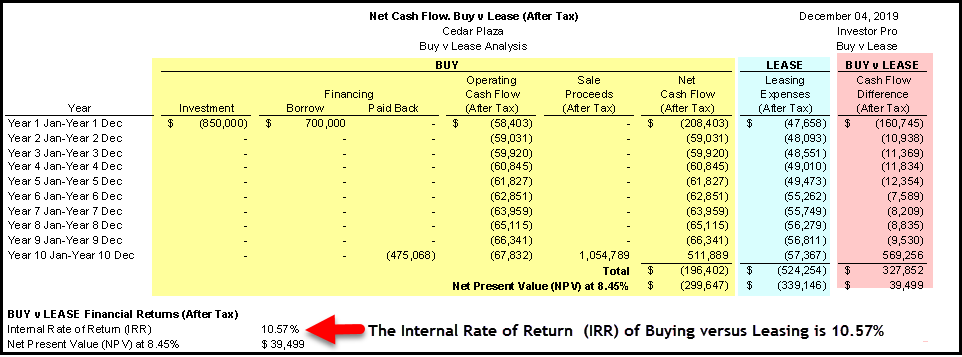
***Your Answer***

**Q4.**

Show me an example of “Buy versus Lease Analysis”

***Flip Side***

Take the after tax Cash Flow of buying subtract the after tax cash flow of leasing to get the differential cash flow of Buy versus Lease. Calculate the “Buy versus Lease” Internal Rate of Return (IRR) and Net Present Value using the investor’s discount rate.



**Q5.**

How is the “Return on Investment (IRR)” or the “Discount Rate” determined when carrying out Buy versus Lease analysis?

***Flip Side***

In order to consider Buy versus Leasing the company has to have enough capital for the down payment of the property. If they don’t have sufficient funds they won’t be able to purchase a property and their only option is to lease or continue to lease.

Example. A company is leasing space and the lease is about to be renewed and they have $900,000 cash to use to purchase a property worth $2,000,000 using a $1,100,000 mortgage and $900,000 equity.

The question is what is an acceptable Return on Investment (IRR) to use when carrying out buy versus lease analysis.

It depend on how else can they use the $900,000 cash. Some options are:

Investit in the stock market. Assume they can make 3.5% after tax

Use the $900,000 to expand their business. Expected return 7.00% after tax

In this case if the Buy versus Lease analysis indicated a return of higher than 7.00% they should consider buying instead of leasing. If not, they should consider leasing.

**Q6.**

How do you evaluate the Return on Investment of buy versus lease using the Internal Rate of Return (IRR) and Net Present Value (NPV)?

***Flip Side***

An engineering firm is considering buying property instead of leasing space and would purchase a building instead of leasing if the Internal Rate of Return after taxes was 8% or higher.

In other words their discount rate is 8.00% after taxes.

Results of the Buy versus Lease after tax analysis

Internal Rate of Return (IRR): 12%. Consider buying instead of leasing

Internal Rate of Return (IRR): 7%. Consider leasing instead of buying

Net Present Value (NPV) at 8.00% Positive. Consider buying instead of leasing

Net Present Value (NPV) at 8.00% Negative. Consider leasing instead of buying

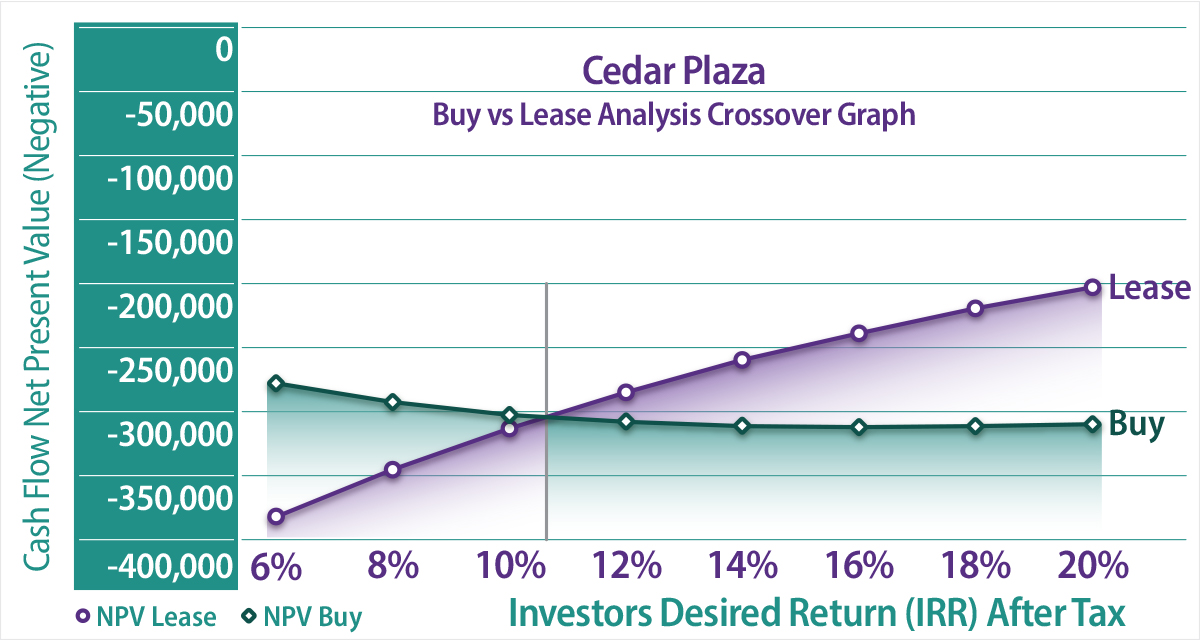
**Q7.**

What’s the Buy versus Lease crossover graph?

***Flip Side***

Shows the cut-off point between buying and leasing.

As an example, if the company can invest their money at more than 10.40% they should consider leasing. If not, they should consider buying.

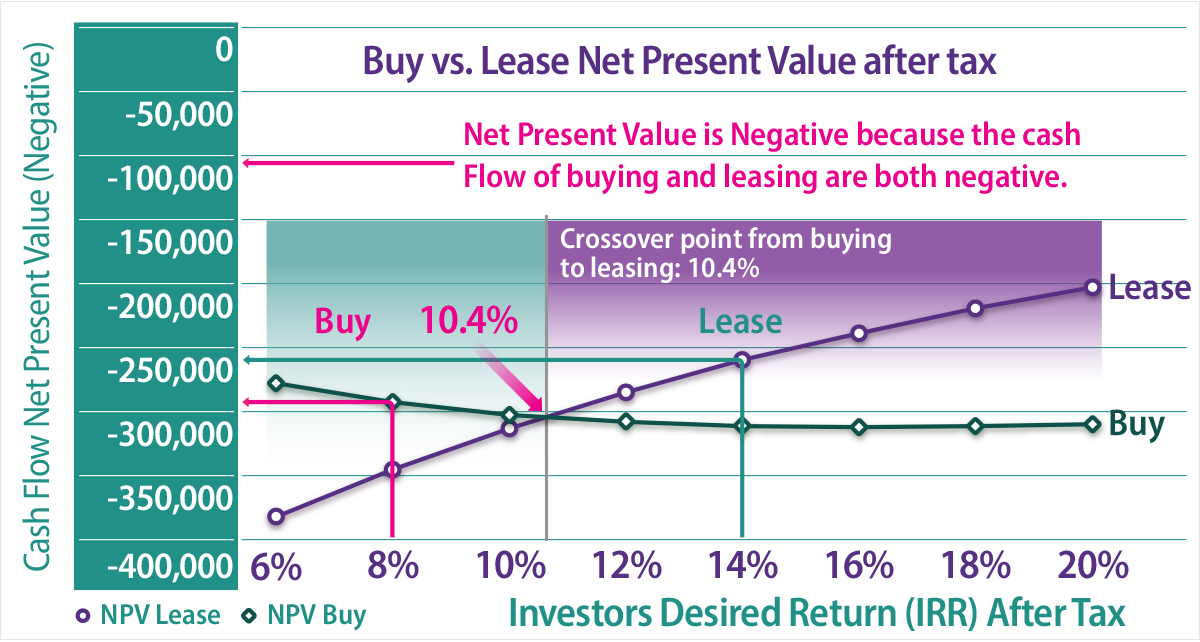


**Q8.**

How do I interpret the Buy versus Lease crossover graph?

***Flip Side***

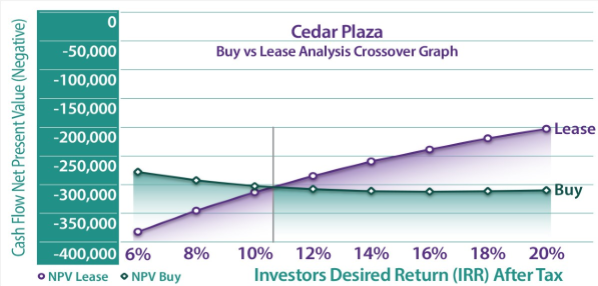
The trick to reading the crossover graph is to recognize that the vertical axis shows the negative Net Present Value for “Buy” and for “Lease” because the cash flows for buying and for leasing are both negative.



**Q9.**

A retailer is considering buying a property instead of renewing the lease. His “Desired Return (IRR)” is 12% after tax. If he can’t get at least an 12% after tax he feels he would be better off using the money to expand his business.

A consultant developed the ‘Buy versus Lease Crossover graph. Should he buy or lease?



***Your Answer***

**Q10.**

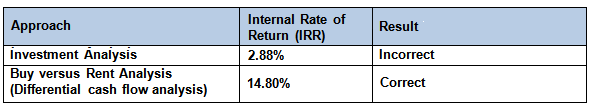
The incorrect way to analyze whether to buy or rent a home or commercial building.

***Flip Side***

A common but incorrect approach is to look at the home as an investment and calculate the Return on Investment (IRR) of owning a home and decide if the return is acceptable.

This approach is completely wrong because it is ignoring the savings in the rent payments.

This is a case study summary of comparing the financial results of treating the home as an investment compared to carrying out buy versus lease analysis.



**END**

# 

# Tip for reading a lease

**Q1.** Why is it so important to read a lease very carefully?

***Your answer***

**Q2.**

How do you determine what expenses are paid by the landlord, and by the tenant?

***Your answer***

**Q3.**

What is a Demolition Clause?

***Your answer***

**Q4.**

Tips for reading a lease

*Flip side*

Read the lease several times. Leases are complex legal documents and need to be read carefully.

Ask a question and go looking for your answer in the lease. Read with a purpose. Have a question in mind.

Examples

Is there a “Demolition Clause?

When is the next rent increase and how is it calculated?

What operating expenses does the tenant pay?

ETC.

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**Q5.**

How are the renewal rates in a lease determined?

Also called “Rent Steps” or “Rent bumps”

***Your answer***

**END**

# Demolition Clauses

**Q1.**

What is a “Demolition Clause?”

***Your Answer***

**Q2.**

Why would a landlord include a “Demolition Clause” in a lease?

***Your Answer***

**Q3.**

From the landlord’s perspective what is the disadvantage of a “Demolition Clause” in the lease?

***Your Answer***

**\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_**

**Q4.**

What types of properties often have a “Demolition Clause” in all the leases in the building?

***Your answer***

**Q5.**

If a landlord insists on a demolition clause and the tenant really wants to rent the space because of its location how can you modify the demolition clause so that it helps the tenant financially?

***Your answer***

**Q6.**

If an investor or developer is looking at buying an older building which has 5 tenancies what’s one of the first things the investor should look for in the lease?

**Your answer**

**Q7.**

Does a demolition clause affect the value of older commercial properties and make it easier or harder to sell?

***Your answer***

**END**