The Economics of Ownership

Provided by PW Development

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When we began to develop the first **Personal Warehouse™** project in 1999, we asked the reasons why. **Why** do self-storage units only go up to 200 square feet? **Why** are there no mid-size warehouses to lease for small buisinesses and personal storage? **Why** can't you purchase a unit like this at an affordable price? All great questions, and – – simply put – **it comes down to economics**. Here is what we found:

1. WHY IS OWNERSHIP MORE COST-EFFECTIVE?

It has always been the norm to lease commercial real estate and storage. However, on average, you can save **up to 40% per month versus renting.** This is because of several factors. Nationally, rental rates of industrial properties have **increased by 5.4% year over year** since 2015. Additionally, office rents have increased by 4.1%, with an average expectation of an annual 3% increase. Rising rents have made ownership more attractive, and much more affordable. When you own, you typically lock in your cost of ownership and avoid costly escalators typically found when leasing.

For example, the rental rate range on small industrial / office space is from $15 to $28 NNN in most markets. If you were to lease 1,000 square feet, your average monthly base rental rate would be between $1,500 to $2,300 NNN per month. Assuming a purchase of this same space at $300,000 ($300psf) with 25% down payment ($60,000) and a 25-year fixed rate loan at 4.0% your monthly payment will be approximately $1,183 per month (principle & interest only). Savings can be up to 40%, not to mention the tax benefits and the fact that your payment won't go up. **Don't forget that a portion of your payment goes towards principle as well!**

2. WHAT IS A CAP RATE AND ITS IMPACT ON LEASING?

The Capitalization Rate (CAP Rate) is the ratio of net operating income (NOI) to property asset value. One way to think about the **CAP Rate** is that it **represents the percentage return an investor** (landlord) would receive on an all-cash purchase or ownership of a property. It is reasonable to expect that an investor would seek a higher return on their investment versus a bank. Most smaller investors seek CAP Rate investments in the range of 8–12%, while large life insurance companies and institutional investors are in the range of 5–10%, depending upon the investment. As a buyer, it is easy to view interest rates as being comparable to CAP Rates. Generally, **banks now lend between 4% and 6%, which can be 40–60% LOWER than a landlord's CAP Rate expectation**. Here is the opportunity for you as an owner to take advantage of that spread, and keep the difference in your pocket.

3. WHY IS NOW AN ATTRACTIVE TIME TO BORROW?

Interest rates have been at a historical low, and although small increases have been realized, they remain very attractive. Unlike in 2008, banks are aggressively seeking owner users and business clients in commercial real estate. With low interest rates and a competitive banking environment, **the time is right to leverage this to your long-term advantage.** It is important to note that as interest rates rise, rents often rise as well. By borrowing upon **a fixed rate loan**, you can eliminate costly price increases over time, **saving you thousands of dollars over the life of your investment**.

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4. WHY IS AN ASSET BETTER THAN AN EXPENSE?

Expenses are costs related to running a business, and are deducted from revenue to determine the profitability of a company. Reducing expenses is essential to all business owners. The trick is to **turn an expense into an asset**. An asset is an item that a company owns, and includes buildings, land, vehicles, and manufacturing equipment. Leasing space is an expense, while owning your location is an asset that adds to the company's balance sheet. The **long-term tax impacts, and the potential for appreciation, can add tremendous value to the company**, lighten your expenses and increase your company's borrowing power. These are positive impacts for any company.

5. WHAT ARE THE TAX BENEFITS?

Taking advantage of all the available **tax write-offs on your property** can make a big difference in your profitability. Whether for investment, business, or even personal use, the deductions and savings can really add up.

Owner-user tax deductions for business uses

Points, closing costs and interest paid on a loan are all tax deductible. Deductible closing costs include: obtaining an appraisal or inspection required by the lender, loan insurance premiums, title fees, loan origination fees, recording fees and abstract fees. These points and fees, paid on the loan, are deductible over the life of the loan. This means that **if you secure a 20-year loan, you can deduct one-twentieth, or five percent, each year**. If you sell the property and pay off the loan, you can write-off the remaining fees and points in the year the property is sold.

Rental tax deductions

Thinking of renting your space or partially leasing it? As an example, if rental income is $12,000 and your allowable deductions total $9,000, you would only owe taxes on the remaining $3,000. If your deductions totaled $14,000, you could use the excess $2,000 against other income, or hold it over into the following year.

Disclaimer: Taxes are subject to change. Please check with your tax advisor.

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6. WOULD IT MAKE A GOOD INVESTMENT / RENTAL PROPERTY?

Absolutely! There are always good people and business' looking to lease smaller, more affordable, flexible spaces. On average, about 10-20% of our buyers are investors looking for a better investment in real estate. Residential properties require more maintenance and management compared to a **Personal Warehouse™**. They also require significant capital investments over time. Personal Warehouses are essentially concrete, masonry, and metal, making them able to better withstand time and tenants.

Another key difference between residential and commercial leases is how the expenses are handled. Generally, in a residential lease, the tenant pays for their base rent and possibly their utilities. The landlord pays the property taxes and insurance and maintenance costs out of the base rents received. In **commercial real estate, there are many lease options**; however, the most common is what is called a NNN Lease. In **NNN leases, tenants take on the responsibility of major expenses such as HVAC and repairs, keeping the operation cost lower for the landlord.** Also, the tenant is responsible for any HOA Fees and the property taxes over the term of the lease. This structure is considered very risk adverse for investors, making it much more attractive to them.

7. WILL I BE ABLE TO SELL IT LATER?

On average, **about 10% of units in a Personal Warehouse™ project resell each year**. In fact, most of our projects have a waitlist of buyers looking for spaces, in addition to existing owners who are looking to expand. Our company, PW Development, LLC., facilitates most of the resales; however, there is no obligation to use us. Any commercial broker will be able to assist you and you can sell it directly. Most owners prefer to be represented and understand where the market is to maximize resale value.

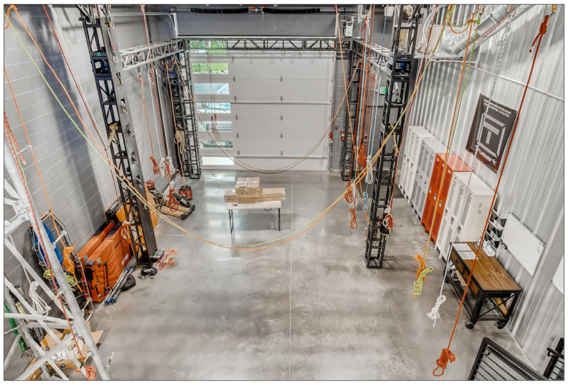
The other question is, **will it appreciate?** Clearly, we can't predict the future, but **over the past 18+ years we have seen steady increases in values.** During the Global Economic Crisis (2007-2009) we did not see values move much. The commercial real estate market saw an average decline of 40%; however, we saw closer to a 20% decrease. During this period, most owners held on to the units and waited for a more favorable time to sell. Today, prices are well above the highest prices in 2007, and we continue to see steady demand for the product.

8. WHAT ARE HISTORICAL APPRECIATION RATES IN COMMERCIAL REAL ESTATE?

In the past, **commercial real estate** has been a stable investment option, providing **competitive adjusted returns**.

"Private real estate is less risky than stocks and bonds," says Craig Evans, CCIM, senior director of Cushman Realty Corp. in New York. *"The standard deviation of overall returns is much less than other asset classes. Variability is approximately 40 percent less than bonds, the next most stable asset. Therefore, on a risk-adjusted basis, the* ***real estate returns are attractive."***

The overall **real estate yield from 1987 to third-quarter 2000 ranged from a low of 11 percent to a high of 12.4 percent**, according to investment surveys by the Chicago-based Real Estate Research Corp. This stability contrasts sharply with the yields on 10-year Treasuries, which ranged from a high of 9 percent in those early years to a low of 5.4 percent more recently.



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A **Personal Warehouse™ is an innovative solution** for business owners, RV users, boat owners, sport enthusiasts, collectors, hobbyists, and entertainment seekers. By creating ownership benefits and incorporating flexible sizes, heat, power, security, and unlimited access, we have developed a new and expanding niche in the warehouse market. Through the development of our numerous projects, **we have seen demand grow** from 'simple' RV storage to a vibrant community made up of toy collectors, hobbyists, retail, office and other business usage. We call our product a '**Personal Warehouse™**' because t**he only limit is your imagination!**

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