Lease versus Buy: Considerations for Behavioral Healthcare Organizations

by Dean Adams, Director of Operations, Community Health Facilities Fund

At some point, every non-profit organization is faced with the dilemma of deciding whether to lease or buy real estate for programs and/or administrative needs. There are many unique considerations, financial, operational, strategic, and mission related, that come into play for behavioral healthcare providers in making these important strategic decisions. Some of the key factors include implications of the organization's reimbursement system for capital costs, how the assets fit into the organizational mission, and the financial risk-reward profile of each option. While every situation is different, there are a few common factors that should be taken into consideration when evaluating whether to buy or lease various types of assets.

Comparing the potential costs and benefits of leasing versus buying from a financial and strategic standpoint is an important step while looking at the organizations future needs. Long term space requirements are an important part of deciding whether to lease or buy. For many newer organizations or those that are growing quickly, leasing will often appear to have significant advantages with cashflow and access to capital being key considerations. Management and the board must also consider the opportunity cost for limited resources that could either be invested in programs and services or tied up as equity in real estate. Ownership can also bring its separate set of headaches – being responsible for maintenance and operations have a great deal of impact. The time and resources required to properly and efficiently manage property can be substantial and may take focus away from programs and services.

Purchasing property for use in providing services certainly has advantages. Building equity over time in real property can be an attractive method for growing the asset base of an organization. Ownership also provides a level of long-term control that leasing cannot. It allows the organization long-term stability in budgeting the expenses related to its occupancy costs. Ownership by a tax-exempt organization also generally provides opportunity to take advantage of property tax exemptions that leasing privately owned property does not.

One simple tool for evaluating these choices is to compare the proposed monthly lease payment to the amount of debt that could be serviced at the same monthly cost. For example, an organization that is paying $20,000 per month in occupancy expense for a facility can service a loan of approximately $2.6 million (assuming 20 year amortization and a 7% interest rate) for the same monthly costs. If property that meets the operating and strategic needs of the organization can be obtained for $2.6 million or less, then strong consideration should be given to purchasing property. This is a simple starting point for this decision-making process but there are obviously many other considerations in making this important decision.

The following are some considerations that an organization should review as it contemplates the best path for meeting is needs for space:

Benefits of Leasing:

- The organization's credit quality is less crucial in a leasing situation than borrowing funds to purchase property.
- Leasing provides more flexibility in the event that the organization's need for the space change over time whether as a result of growth or a reduction in space needs as a result of changes in the programs and services being provided.
- Lease payments in certain reimbursement systems provide enhanced reimbursement versus debt.
- There is less exposure to fluctuations in the market value of the property particularly if there is an urgent need to dispose of property.

Disadvantages of Leasing:

- Lease costs will generally include regular escalation in monthly expenses based on market conditions.
- Any costs related to the renovation of the property for the organization's particular programming or service needs will be lost at the end of a lease.

- Leasing does not provide the potential for long-term growth in the asset value of the property.
- Organization may HAVE to relocate at the end of the lease which may have a negative impact on programs and services.
- Some states look unfavorably upon organizations that lease facilities as it is viewed as a disadvantage in the organization's ability to control costs of services.

Benefits of Ownership

- The reimbursement environment may make the capital costs associated with buying, including interest expense and depreciation, advantageous.
- Ability to budget and plan for the long-term costs of occupancy.
- Ability to take advantage of the long-term appreciation of real estate values.
- Ownership may present opportunities for generating non-operating revenues through the lease of excess space to third-parties.
- As an owner, the organization can make changes to the property to accommodate services and needs
- Ownership allows the organization to control property access and the environment in which services are provides.

Disadvantages of Ownership

- Ownership will generally require a stronger credit profile and more initial capital to secure financing.
- Property values may decline which could impair the organization's ability to provide services and focus on its primary service mission.
- Owning real estate subjects the owner to various legal and regulatory risks not associated with leasing (i.e., environmental, zoning, and land use)
- Ownership of property can distract the organization from its mission and require the investment of time and resources in activities that are unrelated to the primary mission.
- Organizations without expertise in managing and maintaining real estate can incur increased operating costs and inefficiencies that professional real estate management may avoid.

While the decision to buy or lease can seem difficult and overwhelming, there is no one size fits all answer. Every organization will have unique considerations that will change over time as real estate values fluctuate, as the cost and ability to access capital change, as the provision of programs and services change, and as the financial health of the organization changes. For many organizations facing this decision, the thought of borrowing or raising the money to purchase property is as intimidating and overwhelming as it is for a first-time homebuyer. The Community Health Facilities Fund can assist organizations in reviewing and analyzing the spectrum of options and the financial implications of various scenarios in order to develop a strategy that is appropriate for the individual needs of the organization.

CHFF

Community Health Facilities Fund

The Community Health Facilities Fund (CHFF), established in 1991 as a 501c3 corporation, assists non-profit, community-based behavioral healthcare organizations access capital through tax-exempt bonds and/or traditional commercial loans. CHFF can structure and fund traditional commercial loans at attractive interest rates and terms for information technology needs in amounts of $150,000 or more and for real estate secured transactions in excess of $250,000. Contact Dean Adams of CHFF at dadams@chffloan.org or obtain more information at www.chffloan.org.