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One Size Doesn't Fit All

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PM

Own or lease? What is better for you as a franchised automobile dealer? That has been asked often in recent years.

Here are advantages of leasing your real estate:

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- Achieve liquidity, while maintaining ownership and control of the operations of the dealership.
- Lower initial monthly payment since you aren't financing the "residual" (Sounds like a car deal).
- You don't own a single-use facility and can walk away from the property at the end of the lease term.
- Diversify your investments.

There are few landlords active in the national dealership market. Many times, the landlord is the former owner of the dealership who retained the real estate after selling the business.

Most dealership third-party leases are "triple-net," meaning the tenant is obligated to pay rent and, typically, all operating expenses of the property, including but not limited to real-estate taxes, assessments and other government charges, insurance, utilities, repairs and maintenance.

In addition, the leases generally require the tenants to pay for additions, repairs, renovations and improvements to the properties undertaken by the tenant, which, upon expiration or termination of the leases, generally become the property of the landlord.

I don't see any advantages over ownership here. Leases also typically provide for upward periodic adjustments in base rent due from dealership tenants, usually based on a factor of the change in the consumer price index.

Additionally, leases typically reset based on the fair market value of the property at each renewal period.

Here are some of the advantages of owning your real estate:

- Control of the lease terms between your dealership and your real-estate entity.
- Real-estate improvements you make belong to you, not a third-party.
- You get the benefit of any appreciation on the property.
- You can use real estate as collateral for financing needs.
- Availability of long-term fixed-rate financing so the payment doesn't increase as the property value goes up.

Often, when I consider business options, I look at how public dealer groups choose among available options. In this case they follow different courses.

AutoNation and Lithia have usually preferred to own their real estate. Asbury and Penske have typically chosen to lease. Group 1 and Sonic appear to have recently changed their preference from lease to own.

What does this mean to you? That one size does not fit all. For some, leasing appears to be best. For most privately held dealerships, owning is the better option if they have the capital to own both the real estate and the dealership.

Given a mutually exclusive choice of owning a dealership or its real estate, I would choose the first, since return on investment is usually greater. But we are seeing cases today where the real estate is actually worth more than the dealership.

Here are some considerations when making a "lease vs. own" decision:

- Dealership's credit history, liquidity, capitalization, historical profitability and cash flow.
- Location of the property.
- Market value of the land, buildings and other improvements, including the potential for alternative uses and the likelihood that the properties will retain value or appreciate.
- Construction quality, condition and design of the buildings.
- The environmental condition of the real estate.
- The brands of vehicles sold at the dealership.
- Competitive conditions in the vicinity of the property.

Gee, if all these considerations look good, wouldn't you rather own the property yourself? If these considerations don't look good from your prospective, you probably want to be a renter.

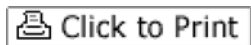
Once again, it depends.

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