Lease Versus Purchase of Public Facilities: Pros and Cons
(By Pat Hardy, MTAS – 2010)

During times of financial stress we sometimes ask, “What are the advantages of leasing a facility as opposed to building or purchasing a facility?” One option tends to provide a sense of flexibility while the other tends to provide a sense of independence. Below are the pros and cons of each.

Advantages to Leasing versus Purchasing or Constructing a Facility

1. Leasing a facility will not count against you in terms of long-term debt, will not affect your bond rating, and will not affect your future ability to borrow. It is a method of meeting capital needs without increasing bonded indebtedness.

2. A lease will usually provide 100% financing.

3. The costs of leasing will largely remain constant, giving you a greater ability to predict expenditures (that’s because the responsibilities for large, unforeseen expenditures such as replacement of a boiler are the responsibility of the owner).

4. Leases are typically easier to finalize, less complex, and quicker to close than issuing bonds. In other words, it can happen quicker with a lease.

5. If the facility is not “specialized” (or highly customized) and can be used by a wide variety of potential clients, then you probably will not have to make significant improvements. The absence of improvements eliminates the potential for loss of value associated with them.

6. You have more flexibility with a leased facility. There is no obligation to stay in the facility over the long-term.

7. You will likely have little or no maintenance on a leased facility. Maintenance is normally the responsibility of the owner.

Disadvantages to Leasing versus Purchasing or Constructing a Facility

1. You lose some control over the facility because of your lack of ownership. The owner may have another use for the facility, may increase the cost of the lease beyond its useful value, or over the long-term you may eventually have to move.

2. You usually lose the value of any improvements you make to the facility.

3. When interest rates are low you may miss the opportunity to finance your own facility at extraordinarily low costs.

4. You will have to “manage” the lease. For example, if the owner allows the building to deteriorate it would be up to the City to hold the owner accountable.

5. Improvements to the facility will not count as an asset to the City on its balance sheet.

6. Unless you lease a facility constructed just for your use, you will likely have a limited choice in terms of where the facility is located

7. As a lessee, you will not realize an increase in a facility’s value. In other words, you won’t build equity. Any increase in value will be to the advantage of the owner. Of course, in a depressed real estate market the opposite can also be true. You could potentially lose value.

8. It is likely you will not be able to “grow” the facility if needed. If additional space is required you could simply add on to a facility you own which may not be an option with a leased facility.

9. If you own a facility and have additional capacity you could have the opportunity for rental income on the property.

In summary there appears to be two overarching themes when considering whether to lease or purchase:

1. Generally if debt service and maintenance costs are less than or roughly equivalent to the cost of leasing, it is probably to your advantage to purchase or construct your own facility. This is especially true when interest rates are low.

2. If you intend on using the facility for a long period of time (more than 10-15 years) then it is probably to your advantage to own the facility. This is also especially true when interest rates are low.

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