

Investing in Commercial Property – What You Need To Know

Commercial real estate may seem like a straightforward subject and ideal investment, but there are many factors to consider! Yes, it can actually be very rewarding and profitable, but there are reasons that commercial real estate investment (CREI) equals only about a third of total investments in residential property.

Many are turning to real estate as an ideal investment alternative to stocks, bonds and mutual funds. Reasons are many, and include that this type of investment is real property that the owner always can see and know the location and status of.

Commercial properties are developed with business in mind, and this affects how any of these properties are valued or handled in a real estate deal. However, this doesn't mean that commercial properties can't also serve the function as a residence for someone.

Apartment complexes are a valued business, and the buildings are considered commercial real estate to those who own them. Other commercial properties, such as strip malls, still deal with tenants in each available unit. This sought-after commercial zoning status greatly increases the value of any property, and also changes the investor's options for financing and tax or insurance obligations.

Commercial investments require a greater upfront commitment from the purchaser, usually upwards of a 20% to 50% down payment. Excellent credit scores will be a prerequisite, and the proposed investor should have an idea of what the capitalization rate and Gross Rent Multiplier will be.

Cap rates should be around 10%, though more recent investors seek an 8% cap rate. This rate is found by dividing the real estate's annual net operating income by the purchase price. The lower the cap rate, the lower the return on the investment. This annual net operating income is figured assuming full tenancy as well.

The Gross Rent Multiplier (GRM) divides the same purchase price by the monthly gross operating income, before expenses are paid. The GRM, cap rate, value of the property, comparables and potential income provided from a property should all be carefully considered prior to buying commercial real estate.

This type of investment is much riskier than residential real estate opportunities, as the economic climate will affect it even more. Business tenants will go under and leave your building, leaving you to cover all of the associated costs.

If you are not a real estate lawyer and want to invest in commercial properties, it's a good idea to invest in hiring one to point you in the right direction. There are an exhausting number of laws and codes that a commercial owner must follow, as well as considering added business costs and drafting rental agreements that are both competitive and protect the income potential of the building.

In addition, several large expenses will be required of the owner to accomplish this task. Fire extinguishing systems, alarm and other security systems, electrical, water and technology considerations as well as parking, lighting and landscaping must all be accounted for. Although commercial investing is much more complicated than some may originally think, it can also be far more rewarding than other investing options.