

# Three Pros and a Con: Benefits of Investing in Commercial Real Estate

Got any real estate in your portfolio? As an investor with likely a keen eye on the future, you may be considering allocating a portion of your portfolio to commercial real estate. Investments in commercial real estate offer many advantages—including portfolio diversification, capital appreciation, cash flow, ownership of a tangible asset, inflation hedging, and tax advantages—that are also available through residential real estate investments. But investing in commercial real estate can confer some extra benefits, provided that you're willing to conduct the necessary due diligence and shoulder the added risk.

Keep reading to get your head around investing in commercial real estate. Find out the major benefits and risks to consider before you take the plunge.

## PRO: Attractive ROI potential

Owners of commercial real estate can generally earn attractive returns on their investments as compared to the average ROI potential of residential real estate. Cash flows from businesses are generally stronger and more stable than cash flows from residential real estate, with residential tenants more likely to be impacted unpredictably by economic downturns or personal crises.

Another factor boosting the ROI potential of commercial properties is longer lease terms. While lease terms for residential properties are generally no longer than two years, lease periods for commercial properties are frequently 3-5 years. A golden rule of real estate investing, whether residential or commercial, is that time—the more, the better—is required for a property to meaningfully gain value. Long lease terms enable commercial real estate owners to better capture capital gains from real estate assets.

## PRO: Professional tenant base

Another benefit of investing in commercial real estate is the ability to work only with a professional tenant base. The conduct of residential tenants may vary greatly, while business owners who successfully operate companies are generally reliable and professional.

Everyone knows that the appearance of any business matters, far more than the appearance of a private home. Business-owning tenants are generally likely to maintain a commercial real estate property to a high standard, because not doing so would negatively impact the business. Commercial tenants take responsibility for many aspects of property maintenance, in addition to paying all taxes levied on the property and business.

Many businesses have limited hours of operations—another benefit to commercial property owners. Unlike residential properties, which are often used 24/7, commercial real estate may sit idle for many hours of the day. The property being in the public eye can additionally boost its security, even when not in use.

## **PRO: More transparent asset pricing**

Investors considering buying commercial real estate can use financial data provided by tenants to determine fair pricing for the commercial property. Receiving information such as tenant income statements can help investors to determine how much cash flow the commercial property is generating, which can help to inform buyers about how much the property is worth.

Even without access to income statements, investors can benefit from more transparent asset pricing that is generally associated with commercial real estate. Business properties are classified by type—office, retail, industrial, leisure, or healthcare—with varying price ranges associated with each category. Knowing the type of commercial real estate can help an investor to better understand the typical price range for that type of property. Residential real estate, by contrast, is much less differentiated, making it more difficult for prospective investors to determine fair pricing.

## **CON: Larger initial investment**

With so many benefits associated with investing in commercial real estate, you may be wondering about the drawbacks. Every investment strategy poses risk, and investing in commercial real estate is no different.

Commercial real estate investing confers both financial and operational risks, with the primary financial risk associated with the size of the upfront investment. An advantage of investing in residential real estate is that the initial cash outlay is generally smaller than the initial cash outlay for a commercial property, with commercial properties generally being larger and more sophisticated. In addition, commercial properties are often located in desirable areas for commerce, further boosting the valuation of the asset.

Commercial property owners can generally assume that business owner tenants will maintain the properties to a high quality standard, but need to be prepared to pay for major repairs or upgrades as needed. A fire or other natural disaster can result in the immediate need to construct a new roof, for example.

Many investors are enticed by real estate investment opportunities. Investing in commercial real estate can confer many advantages and attractive returns, provided that investors are willing and able to shoulder the risks. Conducting thorough due diligence, whether independently or with the assistance of a real estate investing platform like Cadre, is necessary before adding commercial real estate to any portfolio.