

Introduction to Commercial Real Estate

Introduction: Investing in the Engine of the Economy



Welcome to the world of commercial real estate. If residential and multi-family properties are about housing people, commercial real estate is about housing businesses. It involves owning the spaces where people work, shop, and innovate—from retail stores and office buildings to industrial warehouses.

Investing in commercial property is a significant step up in complexity and potential reward. It allows you to diversify your portfolio and align your

investments directly with the economic growth of the Edmonton area. This guide will introduce you to the fundamental concepts, property types, and key considerations for this exciting asset class.

Chapter 1: The Three Main "Food Groups" of Commercial Real Estate

While there are many niche property types, most commercial investments fall into three major categories:

- **Office:** This includes everything from downtown high-rise towers to suburban office parks. As an owner, you provide the space for businesses—like law firms,

tech startups, and corporate headquarters—to operate. The strength of your investment is tied to job growth and the desirability of the location for employers.

- **Retail:** This is the real estate of commerce. It includes shopping centres, street-front stores, and standalone buildings for tenants like restaurants, banks, and grocery stores. The success of retail properties is driven by consumer spending, location visibility, and foot traffic.
- **Industrial:** The backbone of the supply chain. This category includes warehouses, distribution centers, manufacturing facilities, and flex spaces. With the rise of e-commerce, the demand for industrial properties for logistics and storage has exploded, making it one of the most sought-after asset classes.

Chapter 2: The Lease is Everything



In residential real estate, the property itself is the main asset. In commercial real estate, the **lease agreement** is the most critical asset. It is the contract that guarantees your income stream. Understanding a few basic lease types is crucial:

- **Gross Lease:** The tenant pays a single, flat rent, and the landlord is responsible for paying all operating expenses (property taxes, insurance, maintenance). This is common in office buildings.
- **Net Lease:** The tenant pays a base rent *plus* some or all of the operating expenses. This shifts some responsibility from the landlord to the tenant.
- **Triple Net (NNN) Lease:** The "holy grail" for many passive investors. The tenant pays a base rent and is also responsible for paying all three major operating expenses: property taxes, insurance, and common area maintenance. This creates a highly predictable, low-touch income stream for the landlord.

The **lease term** (how long the lease lasts) and the **tenant quality** (the financial

strength of the business leasing the space) are the two most important factors determining the value of your investment.

Chapter 3: How Commercial Properties Are Valued

Commercial properties are valued as businesses, not homes. Their value is derived almost entirely from the income they produce.

The same metrics used in multi-family investing are even more critical here:

- **Net Operating Income (NOI):** The property's total income minus all operating expenses. This is the property's pure, unleveraged profit.
- **Capitalization Rate (Cap Rate):** The standard measure of return. **Cap Rate = NOI / Purchase Price**. A property with a strong, long-term tenant (like a major bank) will have a low, stable cap rate. A property with more risk (like multiple small tenants on short-term leases) will have a higher cap rate to compensate for that risk.

Chapter 4: Key Considerations Before You Invest



- **Longer Timelines:** Finding a tenant for a commercial space can take months or even years, compared to weeks for a residential unit. Selling the property also takes longer.
- **Economic Sensitivity:** Commercial real estate is directly tied to the health of the economy. A downturn can impact businesses, which in turn impacts your tenants' ability to pay rent.
- **Higher Costs:** Transaction costs, property management fees, and the capital required for tenant improvements are all

significantly higher than in residential investing.

- **A Specialized Team is Essential:** You cannot succeed in commercial real estate without an expert team, including a commercial real estate agent, a real estate lawyer with commercial experience, and a knowledgeable accountant.

Conclusion: A New Frontier of Opportunity

Commercial real estate offers a powerful way to diversify your holdings and generate strong, stable returns. It requires significant capital, a patient approach, and a commitment to rigorous analysis. For the well-prepared investor, it's a path to building substantial, long-term wealth.

If you are considering adding commercial properties to your portfolio, let's talk. We provide specialized market knowledge and analytical expertise to help you navigate this complex but rewarding field.

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