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Commercial Real Estate Property Types

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Crowdfunding offers a number of ways to diversify within the real estate asset class. Investors can, for example, become lenders whose loans are secured by a property ("first trust deed investing"), or take an ownership "buy and hold" position so as to participate in a property's potential appreciation. Investors can also diversify among different *kinds* of properties -- and commercial real estate has several sub-classes of property types that an investor should be familiar with.

"Commercial" includes offices, multi-family, and retail

Commercial property assets can be allocated among four major property types:

- Apartments/Multi-Family
- Office
- Retail
- Industrial

Other property types in the commercial sector include self-storage facilities, healthcare properties, hotel/lodging accommodations, and senior living centers. Here, we'll focus on the primary groupings.

Multi-Family. Multi-family residential buildings vary by location (urban or suburban) and size of structure (high-rise or garden apartments). Economic drivers of apartment buildings include demographic trends, home ownership and household formation rates, and local employment growth. Leases are typically short-term (one to two years), and adjust quickly to market conditions. Larger apartment buildings are only minimally affected by any single vacancy. Multi-family properties are generally considered to be one of the more defensive investment types within commercial real estate, though they are still subject to competitive pressures from newer construction.

Office. Office buildings range from large multi-tenant structures in city business districts to single-tenant buildings (like a hospital's medical office building). Rents and valuations are influenced by employment growth, a region's economic focus (finance and high-tech centers need more office space), and productivity rates. Individualized tenant improvements are usually not very involved, but credit quality of tenants is key; re-leases of office space typically require some lead time to consummate. Office properties often have longer-term leases that can lag current market lease rates, so that "step-ups" (or step-*downs*) of rental rates are not infrequent when leases expire. Because these buildings are often leased to businesses (not just individuals), the tenants often demand special features in the leases, including rights of first refusal to rent contiguous space, signage rights, or even building purchase options.

Retail. The retail sector includes everything from smaller neighborhood shopping centers (encompassing, for example, a small grocery, pharmacy and a few restaurants or clothing stores) to large "super-regional" malls that have entertainment activities and can draw shoppers from a great distance. In the remainder of the spectrum are community shopping centers, fashion or specialty malls, outlet malls, and "power" centers with a "category-dominating" anchor tenant like Home Depot or Wal-Mart. Retail properties are most broadly influenced by the state of the national economy generally, especially such indicators as employment growth and consumer confidence levels. More local factors include the property location and its traffic flow; population demographics; and local household incomes and buying patterns. Retail store leases frequently contain a base rent plus a "percentage rent" based on the tenant's gross sales figures. Leases also often have long terms; as with office buildings, this means that after a while lease rates may lag current market rates, and step-ups may need to wait until lease expirations. New tenants may also demand more in the way of space improvements that contribute to the "look and feel" of their business.

Industrial. Industrial properties include manufacturing facilities, warehouses, distribution centers, and research & development space. Manufacturing and R&D properties tend to be build-to-suit buildings that can be difficult to "re-tenant" without extensive modifications, while warehouses and distribution centers can be more generic buildings. Industrial properties are also influenced less by local job growth than by larger economic drivers such as global trade growth (imports and exports) and corporate inventory levels. As with office buildings and retail centers, industrial property leases tend to have long terms, so that over time lease rates can fall behind "market." Perhaps most importantly, industrial properties tend to be occupied by a single tenant, adding another level of risk to the property.

The various commercial property types must each be evaluated differently. The influence of regional economic considerations, market supply and demand, lease terms, tenant credit, and any "pass-throughs" of operating costs on a commercial property varies significantly depending on what type of property is being discussed. Because of this variation, a prudent investor might consider diversifying across several of the major property types in order to reduce his overall investment risk.

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