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John Chand  
204-781-7737

### Food for Thought

The future is something that everyone reaches at the rate of sixty minutes and hour, whatever he does, whoever he is.

– C. S. Lewis

## REAL ESTATE SMARTS

Million Dollar Question: *“Is investment in COMMERCIAL real estate superior to investment in RESIDENTIAL buildings?”*

Dolf De Roos, in his book “Commercial Real Estate Investing” lists the following features that make investment in commercial buildings superior in comparison to investment in residential buildings:

1. **Lease Duration:** Longer leases for commercial buildings mean fewer lease renewals and fewer searches for new tenants. The uninterrupted stream of rental income gives a tremendous sense of certainty. It enables one to project one's finances into the future, calculate one's margins, and expand one's portfolio with confidence.
2. **Assignment of Lease:** If a residential tenant finds a substitute tenant who agrees to take over the lease and the new tenant defaults on rent payments, the landlord cannot go back to the original tenant to extract the rent. However, in case of a commercial tenant assigning the lease to a new tenant, the original tenant continues to be liable for unpaid rent by the new tenant.
3. **The Tenants Pay the Outgoings:** With residential property, the tenants pay only the rent and the landlord pays the property taxes, insurance premiums and maintenance. However, with commercial leases, it is common for tenants to pay not only the rent but property taxes, insurance premiums and maintenance costs as well.
4. **Tenants Earn Their Income on Your Premises:** Since the commercial tenants earn their income from the building, and since they want to increase their income, two things happen. Firstly, when something stops working they do not go through the process of calling the landlord and having him arrange the repair; they, instead, just are likely to have it done themselves as quickly as possible to avoid loss to their business. Secondly, the tenants are constantly looking for ways to enhance your property in their quest to earn even more money there, without any cost to the landlord.
5. **Landlord Pays for Improvements to Commercial Premises:** Many commercial leases have a clause stipulating that if a tenant requires major improvements be made, and if the landlord agrees to make and pay for those improvements, then the tenant shall pay extra rent in the amount of x percent of the cost of the improvements. By this arrangement the landlord increases his equity, cash flow, collateral, tax write-offs and income all at the same time.
6. **Certainty of Collecting Rent:** Unlike residential tenants, most commercial tenants pay by automatic bank transfers.
7. **Upward-Only Rent Reviews:** While residential rentals can decline in a down market, commercial rentals tend not to, because most commercial leases have what is known as an upward-only rent review clause in them.
8. **Government interference:** Most jurisdictions have laws governing how residential real estate is rented. These laws severely limit the scope of actions that the landlord can take against tenants who fail to pay the rent. On the other hand the repercussions of not paying the commercial rent are far more severe.
9. **Management Overhead:** The management overhead of commercial real estate is trivial compared with that of residential real estate.

ESSENCE OF SERVICE REALTY

154 Linmar Way, Winnipeg, MB R2J 4H6 • Fax: 204-663-4421

Phone: 204-781-7737 • Email: [jpchand@mymts.net](mailto:jpchand@mymts.net)