The problem with residential/commercial mixed-use| REM | Real Estate Magazine

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By Ramona Ursu

As brokers who trade exclusively in matching buyers and sellers of apartment buildings, we sometimes run into the issue of mixed-use assets, such as when a rental building hosts retail on the first floor, or when part of the apartment building is, or becomes, office space.

For investors, or owners of apartment buildings, here are some items to consider:

Taxation:

One of our clients ran into this issue while owning a small apartment unit downtown, and finding one of her tenants operated his office out of the rental unit. At first, this seemed harmless since the apartment was rented at a premium rental rate. However, due to the business of the tenant becoming visible to the regulatory bodies, our client received her building tax with a surprising increase, reflective of one of her units being reclassified as “commercial use”. An owner needs to weigh the pros and cons of obtaining a rental increase for commercial use of a residential unit. While this situation is reversible, we believe it should be avoided when possible.

Net operating income variance:

Note that if the use of the commercial unit is temporary, the value of your building is not automatically increased. The way the bank would underwrite the value is based on normalized income, not actual. If the use of the commercial unit is recent, but not temporary, an associated increase in opex (taxation) needs to be considered even if such taxation did not yet come into effect (sometimes it takes municipalities several months or years to catch up).

CMHC Financing:

Professional buyers and those versed in owning apartment buildings will need no introduction on how key a CMHC-insured mortgage is to their bottom line. For the general audience: our government recognizes housing is important and something they want to encourage (developing new affordable housing, keeping costs of housing low). It does so in part by giving insurance to lenders of apartment building assets, which in turn allows lenders be more risky.

If you invest in an apartment building, you get CMHC as a borrower, with the benefit of more money (70+ per cent) and a lower interest rate. CMHC is not generally available for mixed-used assets (there is a disqualifying percentage threshold for the retail component). No CMHC equals higher (regular) interest rates and therefore a higher cash down payment requirement. As a seller, you must understand this limits the pool of buyers. As a buyer (even one with available cash), you must realize you will one day have the same issue when selling the building.

Management:

Commercial tenants are very different than residential tenants. Even an experienced owner of apartment buildings can face new issues when dealing with commercial tenants. Recovery of taxes, management of traffic, noise and loitering, operating hours and many more items can affect the management of the building and residential tenant pool, and ultimately have an impact on the value. The most important issue is keeping the space leased. Retail and commercial spaces have been significantly affected in recent years as people can shop online and work online; an apartment building investor generally invests in this asset type because however the world changes, people can't live online. This simple fact brings a different level of comfort to one's investment, which generally doesn't match the risk factor associated with commercial tenancies.

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