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EXCLUSIVE

25 Big Mistakes Made in CRE Investing

By Joseph Ori, Executive Managing Director, Paramount Capital Corp. | Commentary

Some of the same mistakes are made over and over again which usually results in poor performance, the loss of equity in a property or the loss of the property in foreclosure, says Ori.

WALNUT CREEK, CA— The CRE industry is different than all other industries in that it is a transaction based model. The lifeblood of the industry is dependent on sale, financing and lease transactions.

The most successful companies and individuals in the industry usually complete the most transactions. However, in pursing these transactions the same mistakes are made over and over again which usually results in poor performance, the loss of equity in a property or the loss of the property in foreclosure.

Below are 25 of the biggest mistakes in CRE investing that are the root cause of bad deals.

1. Buying properties at low cap rates.

2. Buying properties because the investment sponsor has idle cash to spend in a commingled or special account fund.

3. Not diversifying a national portfolio by property type, location and industry.

4. Not performing property level and financial due diligence on all properties in a portfolio acquisition.

5. Acquiring properties with negative leverage, i.e., the mortgage rate is greater than the cap rate.

6. Using short term debt to finance a long term real estate asset or portfolio.

7. In underwriting an acquisition, using a terminal cap rate that is less than the going in cap rate.

8. Institutional investors who commit capital to sponsors who have inexperienced senior management teams. The senior management team should have gray hair and been through the two secular CRE downturns of 1987-1992 and 2007-2012.

9. Using overly optimistic rent projections in underwriting a deal.

10. Not analyzing the corporate credit of major tenants.

11. Not analyzing the sales volumes of retail tenants, a key metric when buying shopping centers.

12. Performing shoddy engineering due diligence on an acquisition.

13. Not swapping or collaring floating rate debt.

14. Using high leverage of more than 75%.

15. Using convoluted capital stacks with first mortgage debt, multiple mezzanine loans, preferred equity and owner equity.

16. Not analyzing demographic, economic and social changes in the market.

17. Not hiring bright, hardworking and experienced personnel.

18. Not giving senior level employees an equity interest in the company, portfolio or fund.

19. Assuming real estate entrepreneurs are good corporate managers and capital allocators.

20. Not incorporating the 15 risks of CRE including; cash flow, value, tenant, market, economic, interest rate, inflation, leasing, management, ownership, legal and title, construction, entitlement, liquidity and refinancing into the firm's investment strategy.

21. Investing in a property sector like hotels and senior housing in which the investment firm has no experience.

22. Not obtaining the Kmart discount when acquiring a portfolio of assets that are usually made up of a few queens, a lot of pigs and the rest in between.

23. Not understanding that hotels are 70% operating business and 30% real estate and senior housing is 80%-90% operating business and 10%-20% real estate and value is created by superior management and operational expertise.

24. Following the institutional herd in buying core real estate assets at low cap rates.

25. Not checking the formulas in an XL underwriting worksheet, as there is at least one formula error in every underwriting worksheet.

Joseph Ori is executive managing director of Paramount Capital Corp. The views expressed in this column are the author's own.

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