Commentary

# Commercial Real Estate's Next Boom Comes With Familiar Risks

By Joseph J. Ori

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As the CRE industry enters a new big boom period in 2026 after almost four years of malaise, low transaction volume, defaults and foreclosures, investors must be cognizant of the risks inherent in the investment, financing, and development of real estate properties.

The CRE investment process is a multifaceted process for analyzing, acquiring, financing, managing, leasing, and selling commercial property. There are many steps in the process from evaluating a broker's sales package to analyzing the market in which the property is located, touring the property, raising the appropriate amount of debt and equity capital, closing the acquisition, and managing and leasing the property. Each of these steps is critical to a successful CRE property investment. CRE investment is subject to many risks, as discussed below, that were downplayed during the last few years due to high interest rates, the large bid-ask spread and a stagnant market.

**1. Buying Properties at Low Cap Rates.**

Acquiring CRE at low cap rates is one of the biggest sins that an investor can commit. In 2026, many apartment, industrial and data center properties will be trading at sub 5.0% cap rates. This is due to higher demand for CRE assets, an abundance of capital seeking CRE investments as an inflation hedge, strong fundamentals, and a lower interest-rate outlook. In acquiring commercial real estate assets, it is more important to buy a good asset at a great value rather than a great asset at a good value. The most important criterion in a successful real estate acquisition is to buy the asset below its intrinsic value. Intrinsic value in CRE is buying at true risk-adjusted cap rates and risk-adjusted internal rates of return, which most of the time are above transaction returns. Buying a CRE asset above its intrinsic value or at a low cap rate is rarely, in the long term, a successful investment strategy.

## 2. Not Completing an In-Depth Market Analysis.

Increasing deal volume in 2026 also requires increased market analysis of the market in which the property sits. Proper market analysis is a detailed review of the market where the property is situated. This involves looking at property data such as supply and demand for space, rents, vacancy, new construction, cap rates, competition, and a highest-and-best-use review. As many of you know, technology is changing consumer behavior, affecting the CRE industry both positively and negatively. Many Class A properties that were once top in their local market and in great locations find that the local real estate market has changed and demand for the property has waned or changed substantially. There are many tools available to investors to improve market analysis, including AI software, large-data analytics programs, brokerage reports, and on-site property analysis. A proper market analysis should uncover these key market issues and reduce the risk of market changes that could negatively affect the property's value.

**3. Performing Poor Due Diligence.**

The due diligence process conducted before the closing of a real estate acquisition includes all the procedures to make sure the property, financial and market data provided by the seller and broker are accurate and form the basis upon which the purchase price is based. In the next CRE boom, with a high volume of transactions, it is critical that investors perform detailed due diligence on the assets. This will be especially true in large-portfolio transactions with dozens of properties scattered across the country. Shoddy due diligence can result in poor financial proformas, missed negative lease provisions and critical issues with the property's physical condition, and can lead to lower investment returns and reduced cash flow for the property.

**4. Be Wary of the Term "This Time it's Different."**

These are the four most dangerous in the investment world, especially CRE and are associated with every market bubble and financial crash in U.S. history. CRE investors who overpay for a property by buying at low cap rates will often utter these four words to justify their investment. They will comment that the real estate market is changing and if we don't buy this asset at a low cap rate, somebody else will and our investors will redeem their funds. Or we think we can raise the rents substantially during the next few years and that justifies the high price and low cap rate, or the cost of debt is so low that even borrowing at floating rates, we will be able to flip the property for a nice profit before interest rates rise. Investors in this next boom will be tempted to rely on this term to get a deal done at their peril.

**5. Using Excessive Leverage to Acquire Properties.**

Acquiring CRE assets with high leverage is one of the most common investment mistakes. This was particularly common during the early 2000s and up to the middle of the Great Recession in 2010. Many properties bought during that period had a securitized first mortgage, several levels of mezzanine debt, preferred equity and finally the owner equity. Excessive leverage is nirvana when the market is booming, inflation is high and prices are rising, but is persona-non-grata when the economy and markets tank. Thankfully, the regulated lenders have been very conservative in their real estate underwriting and lending practices, often limiting loan-to-value ratios to 65% or less.

### 6. Poor Management and Ownership Practices.

There will be many new CRE investment firms in this new cycle, and a considerable number will be poor owners and managers. This is very apparent in the CRE industry, especially with apartments. Apartments are the most management-intensive of all real estate assets due to the large number of tenants and leases, high levels of employee turnover and poor management policies. With almost 30 million apartments in the U.S., there are many bad apartment managers whose shoddy policies and procedures lead to low occupancy and subpar net operating income and cash flow. There are also bad owners in the CRE industry, whether they are incompetent, lack serious experience and expertise, or are naïve about owning and operating CRE assets. This includes some of the largest and most prestigious real estate investment managers. As real estate private equity firms grow to immense size, with billions of CRE assets under management, they become marketing machines and asset gatherers rather than real estate managers. The unwritten goals of a lot of these firms are to just raise more and more capital, increase the 1.5% to 2.0% asset management fee and acquire more and more assets regardless of the price and performance.

### 7. Unwise Investment of Idle Fund Cash.

There is an abundance of unused powder or cash that needs to be invested in this upcycle. Per industry data, there are over 200 private equity real estate funds in the U.S. with more than $250 billion in capital seeking deals. The pressure on the sponsors of these deals, from their investors, to use the funds, justify the 1.5%-2.0% annual asset management fees, and generate the projected internal rates of return is immense. Many of these sponsors will overlook the risks above and make bad investment decisions, just to place the capital to work. Sometimes the best deal in CRE is the one that you don't do.

**Joseph Ori is Founder and CEO of Paramount Capital Corporation.**

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