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Eight Common Mistakes HNW Investors Make When Buying Commercial Properties

From trying to close deals on their own to focusing too much on returns, HNW investors should try to steer clear from these costly missteps.

By John Egan

Money mistakes are a fact of life. In a survey by consumer comparison website Finder.com, 78 percent of Americans confessed to making at least one financial gaffe.

Such mistakes typically carry greater consequences for high-net-worth (HNW) investors, though. One slip-up in a commercial real estate deal could easily cost millions of dollars.

To help HNW investors avoid expensive blunders, we've compiled a list of eight common mistakes they make in commercial real estate, along with strategies for sidestepping those errors.

1. **Going it alone**

HNW investors shouldn't believe that they can handle the gamut of functions connected with commercial real estate alone, according to Matt Topley, chief investment officer at Valley Forge, Pa.-based wealth management firm Fortis Wealth LLC.

"In most cases, HNW people earn money due to their expertise in a particular professional field. The trouble occurs when then try to park that money in real estate," Topley says. "Most of the time, they fail due to lack of industry knowledge and inability to execute as a landlord. It's not because they aren't intelligent."

HNW investors should resist the urge to shoulder the entire burden of buying, selling, owning and operating a property, agrees Jeff Sica, president, CEO and chief investment officer at Circle Squared Alternative Investments LLC.

"While we absolutely respect our HNW clients and their business experience, we make it very clear that it is a mistake for them to conclude that they can do everything required for a deal on their own," says Sica, whose Morristown, N.J.-based firm specializes in private equity real estate deals for HNW investors. "Solid deals require a solid team with multiple areas of functional expertise."

HNW investors should build a strong team of professionals to guide their real estate investment decisions, including experts in real estate law, taxes, insurance, leasing and property management, according to Adam Finkel, principal of Tower Capital LLC, a real estate finance firm in Phoenix.

2. Not doing adequate due diligence

HNW investors frequently fall for the sales pitch about a potential investment, but then give little to no thought to what underlies the deal, says Les Kiser, principal and managing broker at Chicago-based multifamily brokerage firm Kiser Group Realty Inc.

“It’s easy to get swept up in the excitement, but just like with any investment, you have to do your due diligence,” Kiser notes. “Make sure everything checks out. I know of too many examples of people losing money because they bought the pitch without doing the research.”

Components of due diligence should include:

- Seeking references from other HNW investors who’ve done deals with the firm that’s making the pitch, as well as requesting case studies for previous projects to help determine how the firm executes deals, how it delivers results and what its investment philosophy is. It should be an “immediate red flag” if the firm refuses to offer this information, says Charles “Chick” Atkins, principal at Atkins Cos., a real estate developer and manager in West Orange, N.J.

- Carefully examining the positives and negatives of an asset. For instance, what are the market comps, how desirable is the location of the property and how has it performed in the past?

- Understanding the risks. This is particularly true when placing money with—and trusting in—a friend or relative in conjunction with a “can’t miss” opportunity, says Randy Hubschmidt, managing partner at Fortis Wealth. “More often than not, high-net-worth people tend to learn the hard way that they would have been better off to have had their money professional managed, and with much better liquidity and flexibility,” he notes.

The bottom line: Know who you’re doing business with.

“A good partner can make a bad deal work, while a bad partner can kill a good deal,” says Cliff Booth, president and CEO of Westmount Realty Capital LLC, a real estate investment firm in Dallas.

3. Not considering portfolio diversification

Just as a stock portfolio should be diversified, real estate holdings should also be diversified, says Michael Smetana, a real estate partner in the Chicago office of law firm Culhane Meadows PLLC. In other words, HNW investors shouldn’t allocate every penny of their real estate money to the office sector.

“Don’t dabble in real estate. Commit to learning about commercial real estate as if it was your business rather than a passive investment,” Smetana says. “With the help of experienced advisers, create a long-term plan for a diversified real estate portfolio, periodically re-evaluate and revise the plan, and stick to it.”

HNW investors should be driven by their advisers’ keen analysis of short-term and long-term investment goals for real estate holdings, rather than by the advisers’ “passions and visions,” says Loretta Thomson, a real estate partner in the Los Angeles office of law firm Greenspoon Marder LLP. Too often, these advisers—particularly in-house advisers—are guided by word-of-mouth chatter, gut instincts and other less-than-trustworthy factors, according to Thomson.

“Acting opportunistically and relying more on the advice of their in-house and outside advisers on asset class allocations will likely go a long way to increase the yield potential of property assets,” she says.

4. **Failing to look beyond the returns**

Booth says HNW investors should look at the big picture of a real estate deal, instead of focusing only on the expected returns. When zeroing in on the returns, it’s easy to overlook risky tactics such as assuming too much debt to achieve returns and being too lenient with underwriting, he says.

“Real estate is not a quick win. It is a long-term investment strategy,” Sica says.

5. **Paying too little attention to tax planning**

Tax planning frequently winds up being an afterthought, Thomson says. For instance, she says, HNW investors might be eager to find a home for a pile of cash, but they may not have weighed the tax consequences of eventually selling a property.

Other factors that should go into tax planning include how the investor will hold the title and how the investor can shield himself or herself from liability, Thomson says.

6. **Not getting a good grasp of the local market**

Many HNW investors don’t thoroughly research the local market before investing in a property, says Nick Giovacchini, director of client services at San Francisco-based real estate investment service AlphaFlow Inc. This research should take into account local information regarding price-per-square-foot comparisons, cap rates, commercial construction activity, zoning regulations and economic growth, he says.

7. **Ignoring the importance of property management**

Owning a property goes beyond simply buying it. An investor must also figure out how the property will be managed.

“We advise our HNW clients that if they want to maximize the investment potential of the property, they are going to have to be thoughtful and deliberate in their management of that property and decide whether they will be adding substantial value or just sustaining a baseline condition,” Thomson says.

Key to this is ensuring that a well-qualified management team is in place, Sica says. He recommends asking these questions about a team that’s already managing a property or one that’s going to be tapped for that job:

- Are the team members organized, proactive and responsive?
- Will tenants be satisfied with how they deal with maintenance issues and emergencies?
- Have they properly budgeted to guarantee healthy cash flow?

"Tenants make choices about whether they want to stay," Sica says. "When they do, they help make the project viable… . If they are unhappy, they walk away, and a great property can be abandoned."

8. **Being unprepared for surprises**

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