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# As The New York Commercial Real Estate Boom Continues, Help Investors Avoid These Common Mistakes

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For commercial real estate investors, the boom mentality continues, and those seeking opportunities continue to flock to New York City. That can spell trouble if your clients are not prepared for the consequences real estate investment can bring, including results that are hard to foresee.

Many investors have concluded New York is the safest, best place to park their money. They may be right. Although there will probably be bumps along the way, real estate in New York City has always rebounded and, over time, grown in value.

The fact remains that real estate investment is full of traps for the unwary. You are already aware of many of them. Some are more subtle: Risks await investors – and their counsel – who enter into investments without a full understanding of their overall tax and financial picture. Even sophisticated investors can be caught out. Consulting with a tax professional as early as possible – while still in the planning stages – can prevent trouble in the long run.

The first lesson for real estate investors, especially those just now getting into commercial real estate (and particularly as a limited partner), is that a real estate transaction or partnership is going to end. Your clients need to take the right steps on the way in so that they will be protected on the way out.

You can help by reminding them that real estate investments can be very good and very profitable, but there are potential pitfalls. Commercial real estate investors seeking to become limited partners in properties and deals need to be encouraged to avoid common mistakes, including:

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- Not understanding the operating agreement. The underlying property might be phenomenal – in the best neighborhood with the best tenants – but if the operating agreement among the partners isn't right, your client could be left without any cash to pay the taxes he or she owes.

What are the danger signs? Look closely at who's running the deal, how the cash is distributed, what the special payments or promotes are for the person running the deal; and how tax income and loss are allocated among the partners.

It can be extremely costly to miss details in the operating agreement. I know of one investor who owned a very successful hotel property – but was losing $10 million a year because of phantom income that was taxed.

- Putting more than one property or deal in one LLC, or investing in one LLC that has more than one property. If something bad happens in one building or deal, your client doesn't want the bank to take back both buildings.
- Getting seduced by the property's features and failing to look at the lease and the financials. In a commercial property, the client *must* focus on the leases and the financial picture, and *must not* get sucked in by the quality of the building, its location or its desirability. The lease terms might explain why the owner is selling the property. Maybe the owner entered into and signed leases with a whole litany of clauses that will ultimately be detrimental. Or, there could be a very large tenant who has a sweet renewal option that might hurt your client down the road.
- Being surprised by taxes. Investors who are used to being limited partners in other kinds of investments, like private placements, get taken by surprise by commercial real estate partnerships. The surprise usually involves taxes. Real estate is a passive investment, and there are rules limiting the amount of losses an investor can take from it. Your client might be more accustomed to investments that provide more tax losses. And there are specific traps. The new Medicare tax can increase taxes owed. It's also important to look closely at state tax requirements.

It is in this instance in particular that you may want to consider having a tax or financial professional at the table. The tax professional can support your due diligence, and also provide you with a broader understanding of the client's full tax and financial picture.

- Not being ready to exit. The decision to sell will come later. But clients have been known to get emotionally attached to their real estate investments, so it's never too early to plant (or reinforce) the idea that there will be a time to exit. The client will want to monitor the property and its value, even when income levels are high, and always remember to fit the property into an overall financial picture. Timing is everything. I'll never forget the client who sold off a property in Florida a week before the financial crisis hit, and made $100 million on the sale.

Bottom line – if your client is tiptoeing or plunging into a commercial real estate investment, help make it a good one – both while it lasts and on the inevitable way out.

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