

Three Common Mistakes in Commercial Real Estate.

Introduction

My name is Daniel Shin. I am a real estate attorney and real estate instructor. I help people carefully buy, sell, develop, finance, and lease real estate. I teach accredited classes for the Commercial Brokers Association, Chicago Title Company, and East King County Bar Association. I am also past-president of the Korean American Bar Association. This article is a list of the three most common mistakes that I see in commercial real estate. Most disputes and mistakes are **avoidable** with careful planning and organization. Do not make these basic mistakes.

Number One: Failing to own real estate in a Limited Liability Company

If you enjoy having your personal, business and real estate assets open to lawsuits and civil judgements, don't use a limited liability company ("LLC") to own your real estate. Instead, just own it in your personal name. That is the fastest and easiest way to close a real estate deal.

If you want to create separation and a wall of protection for your assets, use an LLC to own each business and each piece of investment real estate. LLC's are easier and cheaper to form and maintain than a corporation, yet they can elect to be taxed as pass-through entities or C-corporations like a corporation.

One exception: it is common to own your principal residence in your personal name because you have the benefit of the \$500,000 principal residence capital gains exemption for married couples filing jointly, which many people consider to be a greater benefit than the asset protection of an LLC.

Number Two: Failing To Conduct Due Diligence

Ronald Reagan used to say during the Cold War, "Trust, but verify." When you buy commercial real estate, the seller-side wants you to trust them that the property is in the best location and in the best condition and will make you the most money. Don't trust them. Independently study and verify the property yourself with the assistance of expert consultants during your feasibility period and before closing. That will save you headaches and unpleasant conversations with your spouse after closing. Customary due diligence includes the following:

1. Title review.
2. Building inspection, including sewer lines if there has been a restaurant at the property.
3. Review of leases and material contracts.
4. Land survey.
5. Phase I environmental investigation.
6. Land investigations, such as geotechnical studies and critical areas studies.
7. Land use and zoning review.
8. Franchise and property improvement plans for branded hotels.
9. Franchise and fuel supply agreements for branded gas stations.
10. Financial review.

If you do not know what some of the items on this list mean, that should be very clear evidence to you that you need to hire a team of experts to guide you. Spend the time and money to carefully study your investment before you buy. Be proactive, not reactive. Don't try to save \$5,000 in due diligence fees before you buy, only to spend \$50,000 afterwards trying to sue someone because you made a mistake.

I work with very smart doctors and business executives, but they do not know what most of the due diligence items on the list above mean so they hire experts. It does not matter how smart you are. The real estate industry requires specialized knowledge and experience that the average person does not have. Depending on your plans for your investment property, you may need a real estate attorney, title company, surveyor, environmental consultant, engineering firm, architect and land use consultant. No one is an expert in every subject. Beware the advisor who claims to have expertise in many subjects.

Number Three: Not Following Timelines

When you sign a contract to buy or sell real estate, one of the standard terms states that “time is of the essence.” That means that when you agree to submit a complete loan application within 5 days of mutual acceptance, if you fail to do that, even if you were really busy picking up your friend from the airport, you can lose your earnest money. One of the most common disputes that we see are disputes over return of earnest money on deals where the buyer failed to submit a complete loan application on time and to pay the loan application fee. If you are planning to buy real estate, make sure that you have a clear calendar that lists all of the key deadlines so that you do not miss any dates.

My firm is the largest in Bellevue. We have been in business for 50 years and we serve many of the old, wealthy Bellevue families. Most of our wealthiest clients have a portfolio of commercial real estate. Real estate can be an excellent way to build wealth for you and your family, but you need to carefully study your investments before you close. Be detailed. Be diligent. Don't be impatient. Don't be rushed and make avoidable mistakes.