

# 7 Red Flags to Avoid in Your Next Commercial Real Estate Investment

Protect your portfolio, your wallet, and your sanity with these essential tips every investor needs to know—before signing on the dotted line.

● by Loren Keim



# Introduction: Navigating the Commercial Real Estate Minefield

Commercial real estate can be one of the most powerful tools for building long-term wealth. But it can also be a minefield for the unsuspecting. While the returns can be huge, so can the risks—especially if you miss the warning signs. Whether you're a first-time investor or a seasoned buyer, these 7 red flags should never be ignored when evaluating a potential investment opportunity.

The commercial real estate market is complex and constantly evolving. Economic shifts, changing tenant preferences, and emerging regulations can dramatically impact the value and viability of a property. Smart investors know that due diligence isn't just about checking boxes—it's about protecting your investment from unforeseen pitfalls that could undermine returns for years to come.

In today's market, where competition for quality properties remains fierce despite economic uncertainties, the pressure to move quickly on deals can lead to costly mistakes. This guide will equip you with the critical knowledge needed to identify problematic properties before committing your capital, ensuring that your commercial real estate investments contribute positively to your financial goals rather than becoming a source of stress and financial drain.

## Building Wealth

Commercial real estate offers significant potential for appreciation, passive income, and tax advantages when approached strategically.

## Managing Risk

Understanding the warning signs allows investors to avoid properties with fundamental flaws that could undermine long-term returns.

## Making Informed Decisions

This guide provides practical insights to help both novice and experienced investors evaluate opportunities with confidence.

# Red Flag #1: Pro Forma Fantasyland

If the income numbers are labeled "pro forma," consider this your first warning sign. In the commercial real estate world, "pro forma" often translates to: "We hope this happens." This creative accounting approach is a favorite tactic among sellers looking to inflate a property's perceived value without the inconvenience of actual performance data to back it up.

The most common pro forma manipulations include projecting unrealistically high future rents that exceed market trends, drastically reducing expense estimates below industry standards, or assuming perfect occupancy rates in markets with known vacancy issues. These rosy projections can make a mediocre property look like a gold mine on paper, but they won't help when your actual operating expenses exceed income.

Always request the actual trailing 12-month financials (T-12) that show the property's genuine performance history. Compare these numbers against the pro forma projections to identify significant discrepancies. Additionally, verify major lease terms directly by reviewing the lease documents rather than relying on the seller's summary. Pay particular attention to rent escalations, expense responsibilities, and lease expiration dates.

Pro Tip: Trust, but verify—and then verify again. Dreams don't pay the mortgage.

Remember that sellers are motivated to present their property in the best possible light, which means the burden of validation falls on you as the investor. Historical performance, while not a guarantee of future results, provides a much more reliable foundation for your investment analysis than speculative projections.



# Red Flag #3: Short-Term Lease Syndrome

When evaluating a commercial property, the lease terms and expiration schedule represent one of the most critical factors affecting investment stability. If most tenants have leases expiring within the next 12-24 months, you're not just buying a property—you're buying a significant leasing challenge and cash flow uncertainty.

Short-term lease syndrome is particularly dangerous in single-tenant properties where your entire income stream depends on one occupant. If that tenant decides not to renew, you could face months or even years of vacancy while searching for a replacement, all while continuing to pay the mortgage, property taxes, and maintenance costs. Even in multi-tenant properties, having a high percentage of leases expiring within a short timeframe creates a concentrated renewal risk that can destabilize your investment.

Market conditions can change rapidly, and what seemed like an easily leasable space today might face significant competition or decreased demand when those leases actually expire. Additionally, new tenants typically expect concessions like free rent periods or tenant improvement allowances that can significantly impact your returns during the first years of ownership.

## Lease Examination

Review all lease documents to create a clear expiration timeline



## Market Analysis

Research current market lease rates and vacancy periods



## Risk Assessment

Calculate the percentage of income expiring within 24 months

## Financial Planning

Budget for potential vacancy periods and tenant improvements

Pro Tip: Long-term leases with strong tenants = peace of mind and predictable income.

Ideally, you want a staggered lease expiration schedule that prevents too many renewals from coming due simultaneously. This diversifies your risk and creates more predictable cash flow. Properties with longer-term leases (5+ years) from financially stable tenants typically command premium prices, but they also provide the income security that makes commercial real estate an attractive investment class in the first place.

# Red Flag #4: Sketchy Zoning or Use Approvals

If the property is operating under a variance, conditional use permit, or has questionable zoning compliance, you could be one city council meeting away from a major problem. Zoning and land use regulations dictate what activities can legally occur on a property, and violations can result in forced business closures, expensive retrofitting requirements, or significant limitations on your ability to lease or sell the property in the future.

Non-conforming uses—businesses that were grandfathered in under previous zoning regulations but don't comply with current codes—present a particular risk. While existing operations may be allowed to continue, any significant changes, renovations, or interruptions in use could trigger a requirement to bring the property into full compliance with current zoning laws. This can be prohibitively expensive or even impossible depending on the property's physical constraints.

Special use permits, variances, and conditional approvals often come with specific limitations or requirements that might restrict your ability to adapt the property to changing market conditions. These constraints can include operating hours, parking requirements, traffic limitations, or specific business types that are permitted. Some approvals may even be tied to the current owner or operator rather than the property itself, meaning they don't automatically transfer upon sale.



## Verify Current Zoning

Obtain official zoning verification from the local planning department, not just the seller's representation.



## Check Permit Expirations

Confirm that all special permits, variances, or conditional uses are still valid and transferable to new ownership.



## Review Future Plans

Research whether there are any pending zoning changes or area redevelopment plans that could affect the property.



## Assess Compliance

Confirm that the current use and building specifications comply with all applicable codes and regulations.

**Pro Tip:** Double-check with the municipality before assuming current use is guaranteed.

Always conduct thorough due diligence regarding zoning and use approvals before purchasing a commercial property. This includes reviewing all permits, variances, and approvals directly with the local planning department or zoning board. For properties with complex approval histories, consider hiring a land use attorney to review the documentation and identify potential issues before committing to the purchase.



# Red Flag #5: Deferred Maintenance Disaster

Cracks in the foundation, a roof near retirement, or HVAC systems from the Nixon era can quickly turn your "cash cow" into a money pit. Deferred maintenance represents one of the most insidious threats to commercial property returns because these issues rarely announce themselves during casual property tours and can require substantial capital to address properly.

Sellers are masters at downplaying maintenance concerns, often describing significant structural issues as "just cosmetic" or suggesting that aging systems "have plenty of life left." The reality is that major building systems have predictable lifespans, and approaching these end-of-life thresholds means replacement costs are looming. A new commercial roof can easily cost \$100,000+, while replacing an aging HVAC system in a mid-sized building might run \$250,000 or more—expenses that can wipe out years of positive cash flow.

Beyond the obvious structural elements, pay careful attention to less visible but equally costly issues: outdated electrical systems that don't meet current code requirements, plumbing infrastructure prone to leaks, inadequate insulation, or non-compliant accessibility features. Environmental concerns like asbestos, lead paint, or underground storage tanks can trigger expensive remediation requirements, especially if renovations are planned.



## Professional Inspection

Hire specialized commercial property inspectors with experience in your specific property type



## System Assessment

Evaluate the age and condition of all major building systems against their typical lifespans



## Environmental Testing

Conduct appropriate environmental assessments based on the property's age and use history



## Capital Reserve Planning

Create a detailed capital expenditure budget for anticipated replacements and repairs

**Pro Tip:** Always get a full building inspection, and budget for the ugly surprises.

# Red Flag #6: Tenant Quality Concerns

It's not just about filling space—it's about who's in that space. The quality, stability, and creditworthiness of your tenants directly impact the value and risk profile of your commercial property investment. Watch for tenants with poor credit histories, high turnover rates, or businesses operating in industries facing significant disruption or decline.

Financial stability should be your primary concern when evaluating tenant quality. A tenant with a history of late payments, declining revenues, or poor credit represents a significant default risk. Even if they're currently paying rent on time, struggling businesses often deteriorate rapidly when faced with economic headwinds, potentially leaving you with unexpected vacancy and lost income.

Industry trends matter tremendously. Tenants in sectors experiencing technological disruption or changing consumer preferences may face existential challenges regardless of their current performance. Traditional retail tenants are particularly vulnerable in today's e-commerce environment, while certain office users may be reconsidering their space needs in the wake of remote work trends.



The concentration of your tenant base also affects risk. Having a single tenant represent more than 30% of your rental income creates dangerous exposure to that business's fortunes. Similarly, having multiple tenants from the same industry can create correlated risk if that sector experiences a downturn.

Pay attention to how tenants are utilizing their spaces. Tenants operating at full capacity with plans for growth are more likely to renew than those who appear to be using only a portion of their leased area. Similarly, tenants who have invested significantly in customizing their spaces typically have stronger location commitment than those in generic, minimally improved units.



## Credit Verification

Request credit reports, financial statements, and payment histories for major tenants.



## Industry Analysis

Research industry trends and competitive threats facing your tenant businesses.



## Site Visits

Observe tenant operations to gauge business activity levels and space utilization.



## Tenant Interviews

When possible, speak directly with tenants about their business outlook and satisfaction with the property.

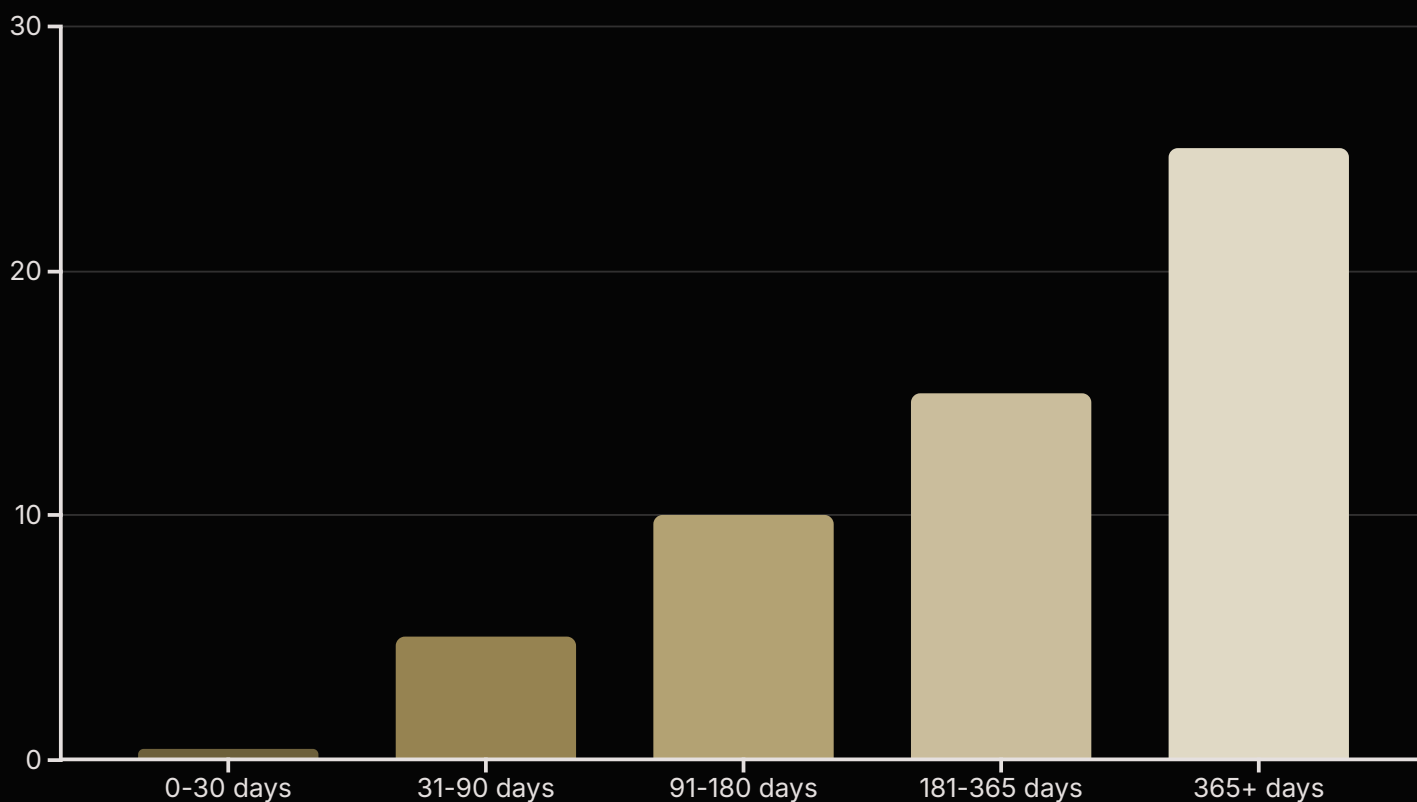


# Red Flag #7: Unrealistic Seller Pricing

If the property has been sitting on the market for 300+ days and is still priced like it's Manhattan in 2019, proceed with extreme caution. Sellers clinging to outdated market valuations or unrealistic capitalization rates are often more interested in recouping past investments than reflecting current market realities—creating time-wasting listings that frustrate serious investors.

Extended time on market (DOM) is one of the most reliable indicators that a property is overpriced relative to its actual value. While premium properties might justifiably command higher prices, they still sell when priced appropriately for current market conditions. When a listing lingers for months with no price adjustments despite steady market activity, it typically indicates a significant gap between seller expectations and market realities.

Market conditions change constantly, influenced by interest rates, capital availability, local economic trends, and property-specific factors. Many sellers base their pricing on historical transactions that occurred under different market circumstances or on their own acquisition and improvement costs rather than current investor return requirements. This backward-looking approach often results in asking prices that no longer align with the income the property can realistically generate.



Beware of sellers who justify inflated asking prices based on "potential" or future upside that requires significant additional investment or speculative market improvements. While value-add opportunities are legitimate investment strategies, they should be priced to reflect the current property condition and performance, with the upside potential representing your investment reward rather than being priced into the initial acquisition.

# Bonus Tip: Trust Your Analysis and Seek Expert Guidance

Trust your gut, but also trust your spreadsheet. The most successful commercial real estate investors combine instinct with rigorous analysis. If a deal looks too good to be true, it usually comes with a catch—one that might not be immediately apparent but will inevitably surface at the most inopportune time.

Develop a standardized due diligence process that you follow for every potential acquisition, regardless of how attractive it initially appears. This systematic approach should include comprehensive financial analysis, thorough physical inspections, detailed lease reviews, and careful market research. Having a consistent evaluation framework helps prevent emotional decision-making and ensures you don't overlook critical factors in your enthusiasm for a seemingly attractive opportunity.

Remember that every commercial property investment represents a complex interplay of physical infrastructure, tenant relationships, market dynamics, and financial structure. A weakness in any of these areas can undermine even the most promising acquisition. Take the time to thoroughly understand each component and how they interact within your specific investment scenario.



When in doubt, seek expert guidance. Even experienced investors benefit from specialized expertise in areas like environmental assessment, building systems, market analysis, or legal review. The cost of professional consultation is minimal compared to the potential financial impact of a significant oversight.

And if you need a second opinion on your next potential investment, our team at CENTURY 21 Keim Commercial is here to help. With decades of combined experience in commercial real estate transactions across diverse property types and market conditions, we can provide the objective analysis and market insights you need to make confident investment decisions.



Visit [www.Century21KeimCommercial.com](http://www.Century21KeimCommercial.com) or call 610-969-7200 to schedule a free investment strategy call.

# Take Your Due Diligence to the Next Level

Want to ensure you never miss a critical factor in your commercial real estate evaluations? Our comprehensive CRE Due Diligence Checklist gives you the professional framework used by successful investors to thoroughly assess potential acquisitions before committing their capital.

This free resource walks you through every essential aspect of commercial property evaluation, organized in a systematic format that makes complex due diligence manageable. From financial analysis and physical inspections to lease review and market assessment, our checklist covers the critical elements that determine investment success or failure.

The CRE Due Diligence Checklist includes:

- Detailed financial verification steps
- Comprehensive physical inspection guide
- Tenant quality assessment framework
- Legal and compliance verification checklist
- Environmental risk evaluation protocol
- Market analysis guidance

Don't leave your investment success to chance. Download our free CRE Due Diligence Checklist today and approach your next acquisition with the confidence that comes from thorough, professional-grade property evaluation.



## Comprehensive

Covers all essential aspects of commercial property evaluation with nothing overlooked

## Professional

Developed by experienced CRE brokers with decades of transaction experience

## Practical

Designed for real-world application with clear guidance and actionable steps

Get our free CRE Due Diligence Checklist to help evaluate your next investment the smart way.

Find it online at

[www.Century21KeimCommercial.com](http://www.Century21KeimCommercial.com)