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Business

Who Represents the
Tenant
in
Commercial
Leasing Transactions?

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**CENTER FOR REAL ESTATE & URBAN ANALYSIS
THE GEORGE WASHINGTON UNIVERSITY SCHOOL OF BUSINESS**



This Executive Summary is based on a 2014 research study and report, the Abstract for which is reprinted below. The research study and report should be cited as:

Smirniotopoulos, Peter E., *"Conflicts of Interest in Commercial Real Estate Transactions: Who Represents the Tenant,"* Center for Real Estate and Urban Analysis, The George Washington University School of Business, November 2014

ABSTRACT:

This study seeks to identify the potential conflicts of interest inherent in real estate transactions between a commercial tenant and a prospective landlord; evaluate the legal, regulatory, and industry mechanisms in place to protect the interests of commercial tenants through professional representation in these transactions; and where necessary, make recommendations for how such tenant protections might be strengthened to assure an arm's length transaction between the parties, thereby optimizing the functioning of the commercial real estate marketplace.

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INTRODUCTION

IN NOVEMBER 2014, the Center for Real Estate and Urban Analysis (CREUA) completed a research study (the “Research Study”) and 89-page report, plus appendices (collectively, the “Report”), under the direction of Project Director Christopher B. Leinberger and Research Director and Principal Author Peter E. Smirniotopoulos, entitled “Conflicts of Interest in Commercial Real Estate Transactions: Who Represents the Tenant?” Professor Leinberger is Chair of CREUA and the real estate program in The George Washington University School of Business (GWSB). He is also GWSB’s Charles Bendit Distinguished Scholar and Research Professor of Urban Real Estate. Professor Smirniotopoulos is Adjunct Professor of Real Estate in the Finance Department at GWSB. He is also Adjunct Professor of Real Estate in the George Mason University School of Business in Fairfax, Virginia. George Mason University is the largest research university in the Commonwealth of Virginia system of public colleges and universities.

The Research Study was undertaken in accordance with a Final Scope of Work dated June 30, 2014, which is included as Appendix A of the Report. The Scope of Work provided a set of objectively determined parameters for the Research Study, which was conducted by Professor Smirniotopoulos in accordance with those parameters. During the study, some of the original components in the Scope of Work were modified by Professor Smirniotopoulos, and implemented with the assistance of the Project Team, to improve and expand the scope and extent of the research being conducted. Those improvements to the Scope of Work are detailed in footnotes 87 and 88, respectively, at page 88 of the Report.

Based on the Research Study, the Report offers a series of Findings and Recommendations, which are presented in this Executive Summary. Readers desiring more-detailed information about the Research Study and the Report are encouraged to download and review the Report, which is available at: https://www.academia.edu/9488812/Conflicts_of_Interest_in_Commercial_Leasing_Transactions_Who_Represents_the_Tenant



FINDINGS & RECOMMENDATIONS

A FINDINGS

- i. **Lack of Transparency and Asymmetrical Information.** The U.S. commercial leasing market lacks transparency and equal access to the same quantum of information by all parties. This asymmetry in access to market information favors Landlords and disfavors Tenants.
- ii. **Market Structure Favors Landlords Over Tenants.** The commercial leasing market is driven by the supply of available premises for lease and not by the demand for such premises. As a consequence, the status quo, including asymmetrical information, supports the interests of Landlords and their brokers, to the detriment of Tenants.
- iii. **Lack of Centralized Organization.** The commercial real estate services (CRES) sector is loosely organized, such that the conflicts of interest issue has not been addressed in any systematic, objective manner benefiting Tenants.
- iv. **Inherently Adversarial Relationships.** The fundamental relationship between Landlords and Tenants is inherently adversarial. In other professional services contexts, such as the practice of law, where the respective parties' interests are so inherently adverse that the conflict cannot be waived, even with the fully-informed consent of both parties, dual representation is prohibited.

B RECOMMENDATIONS

- i. **Further Study.** The Research Study engaged in very limited primary research (which, in and of itself, went well beyond the original Scope of Work). This issue would benefit from significant, primary research into several relevant areas, including the incidence and intensity of the actual occurrences of conflicts of interest arising in commercial leasing transactions.

- ii. **Better and More Centralized Organization of the CRES Sector.** There is a plethora of examples in the United States of how industry self-regulation is extremely effective in protecting consumers while also improving the efficiency of markets. This is a pervasive model for how various professional disciplines assure a uniform level of quality to consumers of that profession's services. Such a system of self-regulation requires, among other things, a centralized, organizing body to which the majority of service-providers belong.

A better and more centralized organization of the CRES sector might emulate the National Association of Realtors (NAR), which provides much of the regulatory and compliance framework for its members, who are then also licensed in the states in which they do business.

- iii. **Development of a Model Code of Conduct for CRES Firms, and Their Associate Brokers and Agents.** Short of following Recommendation B.ii, above, for the creation of a national CRES association to which a majority of firms would belong and contribute (and which would—among other things—develop the regulatory framework for addressing conflicts of interest in commercial leasing transactions), the CRES sector should develop proposed, model legislation to provide uniformity and consistency in the manner in which commercial real estate services are provided throughout the country. Such a model code of CRES conduct would then be provided to state legislatures and interest groups, including consumer advocacy organizations, seeking its widespread adoption.



DETAILED FINDINGS

A THE 'MARKETPLACE' FOR COMMERCIAL OFFICE TRANSACTIONS

i. **A market that functions efficiently serves all parties by facilitating the initiation and completion of transactions.** There are two components to understanding how markets function: Understanding the fundamentals of a "workable market platform" and the concept of market "efficiency."

ii. **In *Reinventing the Bazaar: A Natural History of Markets*, U.C. Berkeley economics professor and author, John McMillan, posits five essential elements of a "workable market platform":**

1. Information flows smoothly
2. Property rights are appropriately protected
3. People can be trusted to honor their promises
4. Externalities are minimized
5. Competition is fostered

iii. **In the context of commercial leasing transactions, Developers and Property Owners control the "supply" of, and Tenants provide the "demand" for, commercial office space, which is the "product."**

This product is made available through Listing Brokers, who provide a variety of services to Developers and Property Owners that go well beyond merely marketing their properties. Listing Brokers market specific versions of the same product type, in the form of "Premises" in a Property or Properties owned by the Developers and Property Owners who are represented by the Listing Broker.

At the same time, agents representing the Tenants—whether Tenant Agents employed by full-service CRES Firms or Tenant Brokers, who represent Tenants exclusively—are the conduit through which the "demand" for specific Premises meeting each, respective Tenant's needs, is matched up with the "supply" of commercial Premises at any given point in time.

iv. **The commercial leasing transactions marketplace does not represent a workable market platform.** In the structure within which commercial leasing transactions are effected, information does not flow smoothly and competition is not fostered. In other words, this market is not "efficient." To the extent the Listing Broker's other relationships and transactions with the Landlord are considered "externalities," they are encouraged rather than minimized. Developers and Property Owners, as well as their Listing Brokers, benefit from these asymmetries of the commercial leasing marketplace, to the detriment of Tenants.

B THE REGULATORY FRAMEWORK FOR LICENSING AND REGULATING COMMERCIAL REAL ESTATE AGENTS AND BROKERS VARIES GREATLY FROM STATE TO STATE

i. **Appendix E of the Report offers a comparative analysis of the licensing requirements for, and the express duties of commercial real estate brokers and agents imposed by, nine states—California, Florida, Georgia, Illinois, Maryland, Massachusetts, New York, Texas, and Virginia—and the District of Columbia.** The Table from Appendix E is reproduced on the following page.

APPENDIX E

Commercial Real Estate Licensing Requirements in
Nine Key States and the District of Columbia

| | CA | DC | FL | GA | IL | MD | MA | NY | TX | VA |
|--|-----|-----|------------------|-----|------------------|-----|-----|-----|-----|-----|
| 1 How many hours of pre-licensing education are required by the jurisdiction? | 45 | 60 | 63 | 75 | 90 | 60 | 40 | 75 | 180 | 60 |
| 2 Duration of initial license before it must be renewed (in months) | 48 | 24 | 18 | 12 | 24 | 72 | 24 | 24 | 24 | 24 |
| 3 Does the jurisdiction differentiate between a license needed to lease commercial and residential real estate? | No | No | No | No | Yes ^a | No | No | No | No | No |
| 4 Do the licensure procedures require any of the following (and, if so, what specifically)? | | | | | | | | | | |
| a. Passage of a test | Yes | Yes | Yes | Yes | Yes | Yes | Yes | Yes | Yes | Yes |
| b. Testing on conflicts of interest issues | Yes | Yes | Yes | Yes | Yes | Yes | Yes | Yes | Yes | Yes |
| c. Commitment to a Code of Conduct | No* | Yes | No* | No* | No* | No* | Yes | Yes | Yes | No* |
| d. Acknowledgment of an agreement to be bound by a prohibition against conflicts of interest | Yes | No | No | No | No | No | No | No | Yes | No |
| 5 Is there a statutory prohibition, as is the case in California starting Jan. 1, 2015, against dual agency? | Yes | No | No | No | No | No | No | No | No | No |
| 6 Is there a statutory requirement that conflicts of interest be disclosed? | Yes | Yes | Yes ^b | Yes | Yes | Yes | Yes | Yes | Yes | Yes |
| 7 Is there a statutory requirement that commercial leasing agents secure each client's written acknowledgment of Items 4c and 4d respectively, if applicable? | Yes | Yes | No | No | Yes | Yes | Yes | No | No | Yes |
| 8 Does the jurisdiction specify the type of and language for the required disclosure? | Yes | Yes | No | No | Yes | Yes | Yes | Yes | No | Yes |

* Although this jurisdiction does not impose a separate Code of Conduct on commercial leasing agents, the regulating statute does set forth a list of affirmative duties that agents owe to their principals in the commercial leasing agency context.

a Illinois has created a specialized license for residential leasing agents.

b Florida only requires disclosure of conflicts of interests in residential real estate sales.

Detailed Findings

C COMMON LAW DUTIES AGENTS OWE TO THEIR PRINCIPALS

- i. Unbroken service and loyalty
- ii. Confidentiality
- iii. Full disclosure of information to allow well-informed decisions by the principal
- iv. Acting in the best interest of the principal
- v. Accountability to the principal

D HOW CONFLICTS OF INTEREST ARE MANAGED IN OTHER PROFESSIONAL SERVICES SECTORS

- i. **The Legal Profession.** The legal profession has had very clear guidance about identifying, disclosing, and avoiding conflicts of interest since 1908. This guidance, which is currently codified in the American Bar Association's **Model Rules of Professional Conduct**, has been adopted, largely in its entirety, by the state bar organizations of all 50 states and the District of Columbia. State and District of Columbia bar organizations have authority over, among other things, the licensure to practice law of, and disciplinary actions against, lawyers in their respective jurisdictions.

A lawyer with a license to practice law in a particular state that has adopted the ABA **Model Rules of Professional Conduct** is prohibited from representing both the landlord and a tenant in the negotiations of a lease agreement or in a dispute over the interpretation of the terms and conditions in a lease agreement, because the interests of the respective parties are so adverse.

- ii. **Financial Services Industry.** Rules and regulations aimed at avoiding conflicts of interest in the financial services industry, promulgated primarily by various agencies and instrumentalities of the United States government, have continued to evolve since first being introduced following the Great Depression of 1929. There has been increasing scrutiny of the incidence and potential negative consequences of conflicts of interest with each domestic and world economic crisis for which the financial services industry has been partially or substantially responsible, particularly where industry self-dealing has been a proximate cause of the crisis. The creation of the Consumer Financial Protection Bureau, and the spate of federal regulations promulgated and enforced by the CFPB, is merely the latest such example.

Requirements for complete transparency in those transactions that are permitted, lists of prohibited transactions, and the obligation to erect, honor, and maintain "Chinese walls" intended to preclude conflicts

of interest within the same firm, are the most-frequent palliatives for the avoidance of conflicts of interest in financial services.

E HOW CONFLICTS OF INTEREST MAY BE MANIFESTED IN COMMERCIAL LEASING TRANSACTIONS

- i. **The Report describes, in detail, the increasing complexities of the real estate development and finance process and, to a lesser extent, the process of acquiring and positioning operating properties in the marketplace.** Coupled with the rapid consolidation that has taken place in less than a decade within the CRES sector, also detailed in the Report, it is easy to understand how the incidence of conflicts of interest in commercial leasing transactions may be on the rise. As these transactions become more complex, it increases the likelihood that conflicts of interest arising out of these complexities are not readily apparent to Tenants represented by the same full-service CRES firm as the Listing Broker.

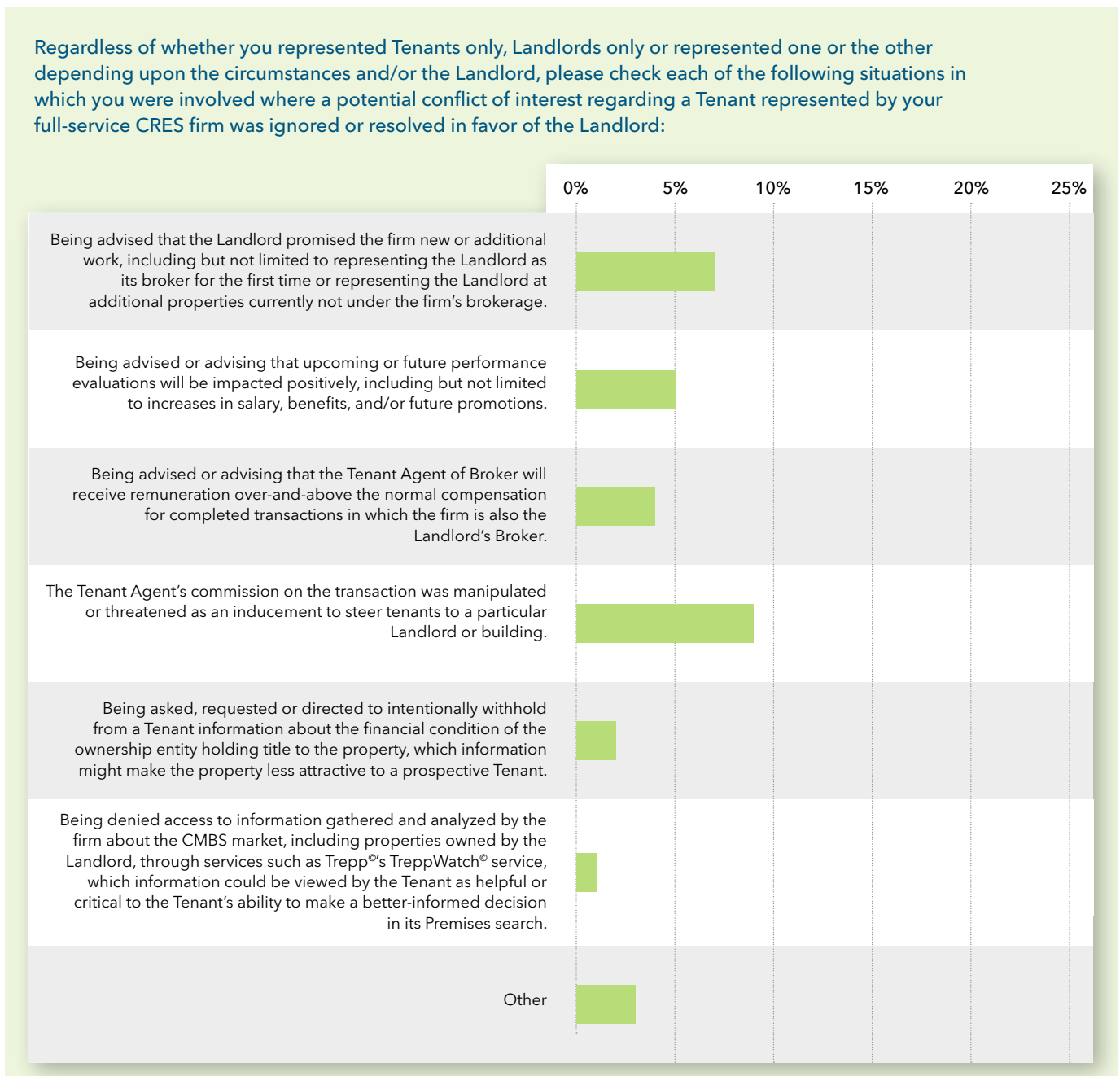
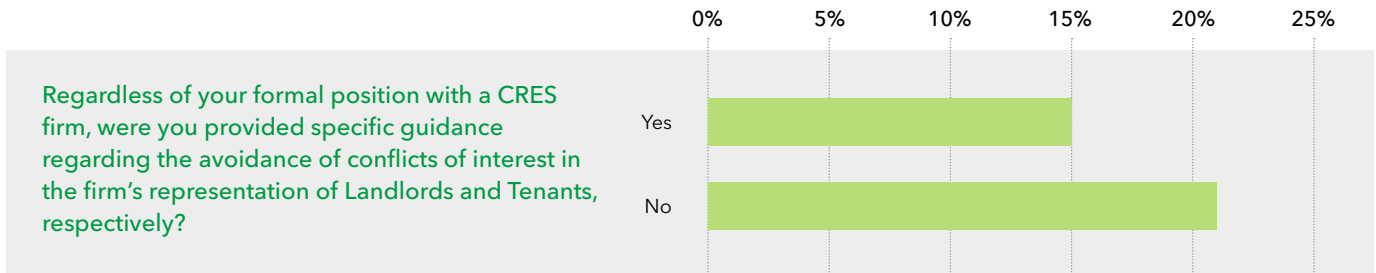
The Report details several real-world scenarios in which there is a potential for conflicts of interest not disclosed to the Tenant, which are resolved in favor of the Landlord and against the Tenant, without the Tenant's knowledge or consent. These include potential conflict of interest scenarios where:

1. The leasing transaction is closed by a Listing Broker and Tenant Agent employed by the same full-service CRES firm.
2. The leasing transaction is closed by a Tenant Agent employed by a full-service CRES firm, which firm is offered incentives by the Developer or Property Owner if the CRES firm is instrumental in tenanting the property.
3. The leasing transaction is closed by a Tenant Agent employed by a full-service CRES firm that is not acting as the Listing Broker but has provided other professional services to the Developer or Property Owner with respect to the subject Property.

- ii. **The Research Study also included two surveys made available to agents and associate brokers formerly employed by full-service CRES firms and currently employed by tenant-only CRES firms.** Respondents to this survey acknowledge both a **lack of guidance** from their former employers regarding the avoidance of conflicts of interest, as well as **specific incidence of conflicts of interest** being resolved in favor of the Landlord. Selected, consolidated responses to three of the survey questions are provided on the following pages. All survey results are included as Appendix C of the Report.

APPENDIX C

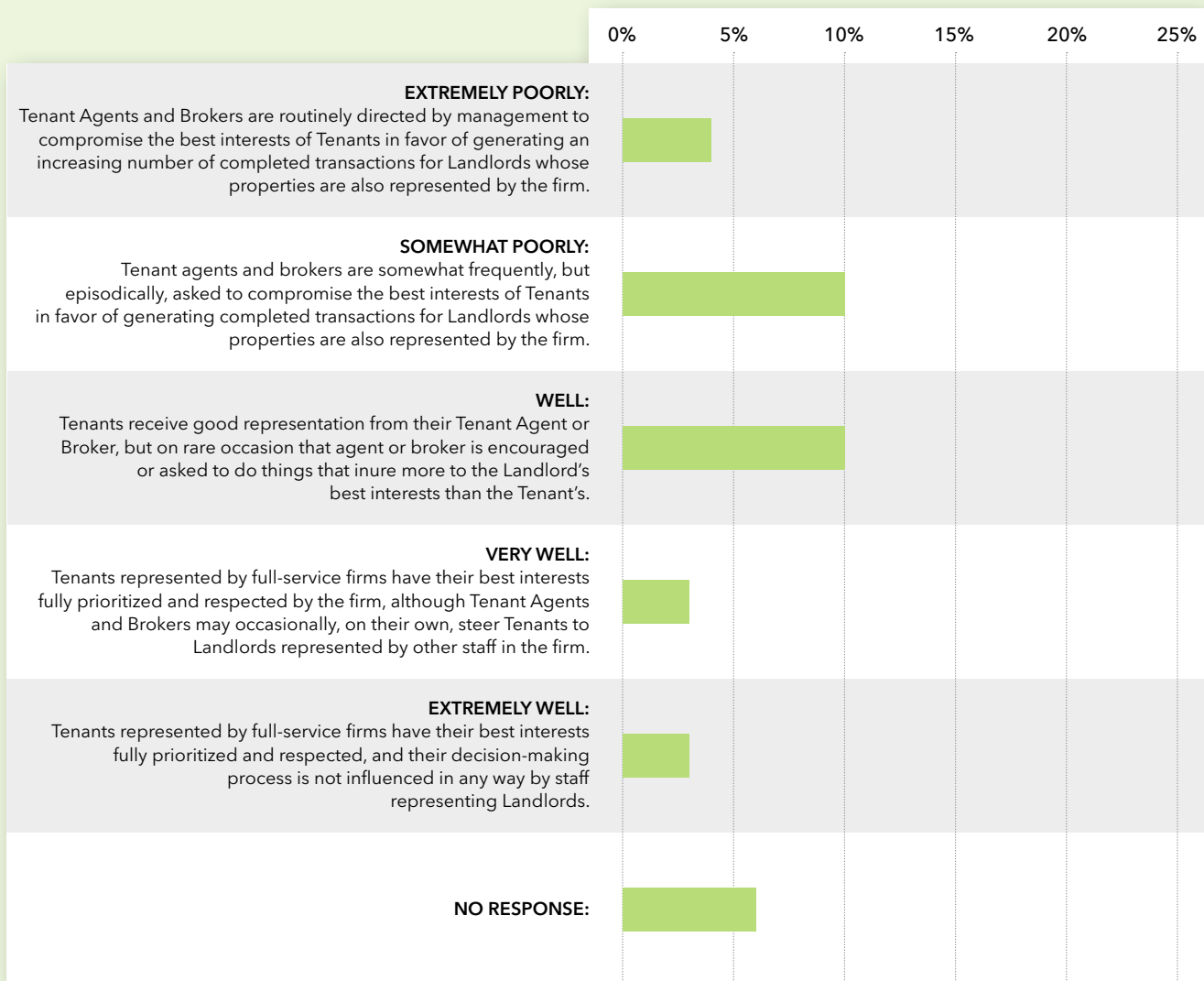
Selected Questions Posed to Agents & Associate Brokers Formerly Employed by Full-Service – and Now Currently Employed by Tenant-Only – CRES Firms



APPENDIX C (continued)

Selected Questions Posed to Agents & Associate Brokers Formerly Employed by Full-Service – and Now Currently Employed by Tenant-Only – CRES Firms

Based on your experience working for your current tenant-only firm, and your prior experience working for one or more full-service CRES firms (as described in your answers to the above questions), how would you rate how full service CRES firms generally handle conflicts of interest:



“This business is rapidly consolidating down to a very small number of players.

The two largest firms [CBRE and JLL] are going to capture the vast majority of the available share going forward. [This] trend is absolute, and I suspect that the mid-tier firms and the smaller firms, you’re just going to see them lose more and more share every quarter and every year.”

—BRETT WHITE, CEO, CBRE

as quoted in

“Largest Publicly Traded CRE Services Firms Finish 2011 With Strong Revenues, Earnings,” CoStar News, February 15, 2012

F IMPACTS OF CONSOLIDATION IN THE CRES SECTOR ON THE REPRESENTATION OF TENANTS

- i. **Continued consolidation of the CRES segment, including the acquisition of Tenant-only brokerages, limits options for Tenants.** In 2013, the five largest, full-service CRES firms were involved in 150,461 commercial property transactions, generating over half-a-billion dollars in commercial property transaction revenues (\$553.3 million in the aggregate). The same, five firms generated over \$16 billion in aggregate, total revenues in 2013.
- ii. **The table below provides information on the five largest full-service and tenant-only CRES firms, respectively.** Appendix D of the Report, where this table also appears, includes detailed information about each CRES firm presented.

APPENDIX D

Comparison of Top Five Full-Service and Tenant-Only CRES Firms

| Company | Service | Ownership | 2013 Revenue | Volume of Leasing Transactions | Dollar Volume of Transactions |
|------------------------------|--------------------------|-----------------|------------------|--------------------------------|-------------------------------|
| 1 CBRE Group | Full-Service | Publicly Traded | \$7,200 MM | 54,225 | \$223,300 MM |
| 2 JLL ¹ | Full-Service | Publicly Traded | \$4,460 MM | 15,000 | \$162,100 MM |
| 3 Cushman & Wakefield | Full-Service | Privately Owned | \$2,490 MM | 35,669 | \$115,000 MM |
| 4 Colliers International | Full-Service | Publicly Traded | \$1,310 MM | 42,100 ² | \$53,000 MM |
| 5 Newmark Grubb Knight Frank | Full-Service | Publicly Traded | \$577 MM | N/A ³ | N/A ³ |
| 6 Savills Studley | Tenant-Only ⁴ | Publicly Traded | \$233 MM | 3,467 | \$58,000 MM |
| 7 Cresa | Tenant-Only | Privately Owned | \$240 MM | 8,400 | \$8,500 MM |
| 8 Fischer & Co. | Tenant-Only | Privately Owned | N/A | N/A | N/A |
| 9 Johnson Controls (JCI) | Tenant-Only | Publicly Traded | N/A ⁶ | N/A | N/A |
| 10 Mohr Partners | Tenant-Only | Privately Owned | N/A | 2,400 ⁷ | \$1,000 MM |

1 Formerly “Jones Lang LaSalle”

2 Including leasing and sales transactions

3 Newmark Grubb Knight Frank’s financials are reported in BGC Partners’ annual report. However, neither the number of leasing transactions nor the dollar volume of transactions are separately disclosed therein.

4 Depending upon how the various Savills Studley offices are operated, as well as the extent of the exchange of information between the Studley tenant-only brokerage staff and the full-service Savills staff on a regular basis, characterizing Savills Studley as a “Tenant-Only” CRES firm may not be an accurate characterization of the firm’s operations in the U.S.

5 Cresa reported “8,400 brokerage transactions” on its website as of the date of the research study report.

6 The portion of JCI’s annual revenues attributable to CRES activities is very small compared with either total revenues or revenues from the core business to which such revenues relate, i.e. Building Efficiency. Revenues from CRES activities are included within segment revenue reported under Global Workplace Services, one of five reportable business segments of the company’s Building Efficiency core business. However, this reportable business segment is not comprised exclusively of revenues from providing occupier services for domestic U.S. customers. The majority of JCI’s global revenues are from the sales and maintenance/service of products, primarily equipment and equipment components.

7 Total number of commercial real estate transactions in 2012, including tenant lease representations.



NEXT STEPS FOR THE CRES SECTOR

A FURTHER STUDY

- i. CREUA could serve as the **clearinghouse for critical commentary** on its Report from various market participants and stakeholders, and then consolidate and report out that critical commentary.
- i. **Primary research** into practices among full-service CRES firms and, in particular, their Tenant clients, including but not limited to:
 - a. Further inquiry into the incidence and intensity of actual conflicts of interest in the CRES Sector.
 - b. Collection, review and analysis, and assessment of conflicts-of-interest policies, procedures, and compliance measures among full-service CRES firms, to establish Best Practices that could be emulated by all full-service firms.
 - c. Primary research into Tenants' depth of understanding of conflicts of interest issues.

B BETTER AND MORE-CENTRALIZED ORGANIZATION OF THE CRES SECTOR.

The CRES sector could create its own framework for establishing uniform rules of conduct and the enforcement of those rules through the creation of a national trade association devoted exclusively to the CRES sector. CRES firms, individual agents and Associate Brokers, public officials involved in the regulation of CRES providers in their jurisdictions, and—of course—Tenants (including but not limited to corporate real estate executives) would all be invited and encouraged to participate actively and substantively in this organization.

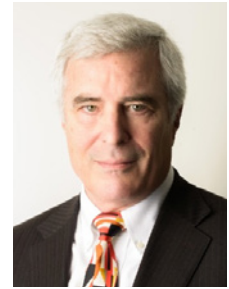
C DEVELOPMENT OF A MODEL CODE OF CONDUCT FOR CRES FIRMS, AND THEIR ASSOCIATE BROKERS AND AGENTS.

In lieu of creating a national CRES organization, the CRES sector could organize an effort to draft model legislation to be provided to state legislatures and interest groups, including consumer advocacy organizations, **seeking to provide uniformity and consistency in the manner in which commercial real estate services are provided throughout the country** (assuming eventual, wide-spread adoption of such model code).

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CENTER FOR REAL ESTATE AND URBAN ANALYSIS

CREUA was formed in 2005 with the following objectives:

- Develop a **first-rate real estate curriculum** for graduate and undergraduate students at GW School of Business
 - Conduct **influential real estate research** focusing on walkable urban place development and management; international real estate; and housing finance policy
- Create **networking opportunities** for alumni and students
- Facilitate **career opportunities** for students and alumni

The Research Study upon which this Executive Summary is based was undertaken by the Center for Real Estate and Urban Analysis in partnership with Cresa, which is part of The George Washington University School of Business' Trusted Partners Program, recognizing companies and other organizations that are philanthropic investors in GWSB.

School of Business

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