

How a New Broker Disclosure Law is Shaking Up the Commercial Real Estate Industry

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Say you're a life sciences company looking for a new location. You approach a commercial real estate agent, who gives the impression he's working on your behalf. But unbeknownst to you, the broker was also working for the landlord of the building you're interested in. What's more, the broker actually had a minority interest in the building. And he never told you any of that.

That scenario has actually happened, according to Jason Hughes, president and CEO of Hughes Marino, a tenant-representation advisory based in California.

"These brokers never told the tenant that they have this conflict," Hughes said. "This tenant went through, they did a crappy deal — the building sold and they didn't have any property tax protection, exclusive use protection."

The possibility is less likely today, Hughes said, thanks to SB 1171, which went into effect Jan. 1. The law, which Hughes pushed for, requires commercial real estate agents and brokers to disclose proposed dual-agency roles to possible

clients in writing before being hired.

Forms must clearly state whether the agent represents only the landlord or seller, only the tenant or buyer, or both sides. (Dual agency representation is perfectly legal, and can be an efficient and effective route for both sides depending on circumstances.) Consequences for violating the law include losing your real estate license.

Residential real estate agents have long been required to make such disclosures, but the commercial sector was exempted because of the expectation that parties in these transactions are much more sophisticated and understood who was representing whom.

In fact, that generalization ignores a huge swath of the industry — such as mom and pop dry cleaners and other small businesses — that don't understand agency, said Ron Rossi, a shareholder with Rossi, Hamerslough, Reichl and Chuck who was involved in the legislation with associate Laurel Champion.

"It's designed to avoid conflicts, and disclose potential conflicts, sort of like lawyers have to do," Rossi said. "You can come see me but, by the way, I used



Jason Hughes, President & CEO, Hughes Marino

to represent this person you're suing. Before you engage an agent to represent your interest, you should know that."

Beyond simply creating better-informed customers, the law is likely to have a far-reaching effect on how business is conducted, people in the industry said. One example: The law effectively expands who is considered



a dual agent, because agency is established at the corporate level, Hughes and Rossi said.

For example: Say Tricia Tenant Rep only works with retail tenants at CBRE. She could be considered a dual agent if someone else at CBRE has a relationship with the landlord of a building she's negotiating on. Traditionally, Tricia wouldn't call herself a dual agent because she exclusively works with stores. Now, that could change, depending on the transaction.

And that's a good possibility, because brokerages like CBRE, JLL and DTZ continue to grow ever larger. For the hypothetical Tricia, being branded a dual agent could hurt her ability to attract clients if they think she might not have their best interest at heart.

What's more, as a dual agent, Tricia is restricted in what kind of information she can share with her client — such as intelligence that the landlord would accept less rent (unless the landlord explicitly gave her permission).

"In reality, that relegates you to being a messenger," Hughes said. "What if this particular landlord is trying to sell the building and they need to make this thing happen?"

Hughes acknowledges the law effectively benefits his business model of only focusing on tenants. He says the industry has for too long been tilted favorably toward landlords, who pay the bulk of the industry's commissions (including the tenant rep).

"The legacy companies — that's what I call these firms — they're antiquated networks with old-school business models," he said. "These guys were there to serve the landlord. They were able to monetize the tenant too. But ultimately that's in service to the landlord, which is where they make their money."

Brokerages, he said, will inevitably gravitate toward serving exclusively tenants (such as Cresa Partners and SRS Real Estate Partners) or landlords.

Rossi was more doubtful it would upset any apple carts.

"It hasn't affected the residential real estate substantially," he said. "They have to do it right. They have to deal with all the forms and disclosures.

You want brokers negotiating in your best interest. But at the end of the day both sides want to do a deal."

As for that life sciences company in Southern California?

"A new CFO came in and said, 'Why

is this a bad lease?'" Hughes said. "He found out the brokers represent the landlord in this building and others. Now there's documentation. If someone lies and gets caught lying, they will lose their license."

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Jason Hughes is president and CEO of Hughes Marino, an award-winning California commercial real estate company with offices in San Diego, Orange County, Los Angeles, Century City, San Francisco and Silicon Valley. A pioneer in the field of tenant representation, Jason has exclusively represented tenants and buyers for more than 25 years. For more information, contact Jason at toll-free at 1-844-NO-CONFLICT or jason@hughesmarino.com.