

The typical tenant may become engaged in a search for space only once every ten years. It's difficult to become an expert in anything if you only do it once per decade. Also, the usual situation is that the space searcher has very limited knowledge about the state of the property market, for example:

- What are the true occupancy costs in the various markets,
- Where are the space options located, and
- What are the physical and operating conditions of the building alternatives?

Of course, tenants also wish to minimize their occupancy costs; but that is very difficult to compute when the contractual agreement, the lease, is often a document that can run to over 100 pages. The lease specifies not only the rent but also how the space may be used, and the landlord's responsibilities for operating the building. All of these provisions can have profound impacts on how efficiently the tenant can utilize the space in the operation of its firm. In addition, it is largely out of prior experience that one learns how the various provisions of the lease can impact the tenant's true occupancy costs over the term of the lease.

THE GUIDING LAWS OF PRINCIPAL AND AGENT

In our society, these complexities and uncertainties are not unique to the occupier's search for space. We hire attorneys to represent our interests in legal conflicts. Financial advisors and stock brokers are used to manage or help us manage our financial assets. When we are sick, medical doctors are engaged to treat and cure us. In all of these instances we want to be sure that the "expert" agrees to and does act in a manner where our interests are paramount. That is, the actions taken by these professionals on our behalf are guided by the oath that our welfare comes first.

Societies have recognized the complex and tenuous relationship that arises when someone hires a professional to perform a service for them. Usually, the Principal engages the Agent because the Principal has a task that S/he does not have the training or experience to perform. The Principal is to a large extent at the mercy of the Agent. The Principal simply does not have the training and knowledge to know if the Agent did the best job possible for the Principal's interests. One aspect of this conundrum is referred to as the problem of

CONFLICTS OF INTEREST

Who Represents the Tenants?



asymmetric information. In the financial market, this problem is addressed by various laws that deal with **insider trading**. The legal profession has very well defined and rigidly enforced rules about conflicts as they relate to the **representation of clients**. Perhaps the oldest Principal Agent rule of conduct is the **Hippocratic Oath**.

DOES COMMERCIAL REAL ESTATE HAVE A PRINCIPAL-AGENT PROBLEM?

Many types of transactions executed in the commercial real estate industry are done between fully knowledgeable experts. However, there is one area where a clear violation of the simple precepts of fair dealing in a principal-agent relationship can arise: the representation of tenants by brokers who are acting as agents in the tenant's search for space.

The problem arises when the broker who has entered into a contract to represent and negotiate for the tenant also represents landlords as agents for the leasing of space in their buildings. While the nature of the business conflicts can be subtle and complex, in its simplest form it really comes down to representing both sides in a negotiation over the terms of the lease.

What if the tenant is informed by the broker that she does also represent landlords? Does disclosure mean that the tenant has been forewarned and with extra caution the tenant will still get the best deal possible? The answer likely goes back to the issue of asymmetric information and the fact that the tenant retained the broker in the first place because the tenant simply

Getting Conflict-Free Representation in Your Search for Space



doesn't have the knowledge about the markets and buildings to perform the search without specialized help.

In the legal profession, they simply prohibit representing both sides in a dispute.

A broker might argue that he represents the tenant and that the firm he works for has other brokers who represent landlords. It is asserted that the two sides of the firm never talk to each other. It was found in the financial industry that "Chinese Walls" are porous. In the commercial real estate industry, impartial investigations of commercial real estate transactions have begun to issue warnings about conflicts of interest in these arrangements.

On June 12, 2013, the Office of Inspector General United States Postal Service issued a report on a contract awarded by the U.S. Postal Service to CB Richard Ellis, Inc., making it the sole provider of real estate management services to more effectively use its limited resources. The purpose of the Inspector General's report was stated as, "Our objectives were to assess the inherent risks of the contract and determine whether the Postal Service effectively provided oversight to reduce these risks."

With respect to conflicts of interest, the Inspector General's report said, "Conflict of interest concerns exist because the contractor provides a range of property values to negotiate a lease and receives a commission from the lessor based on the property value negotiated. Further, the contractor acts on behalf of the Postal Service in negotiating leases and the contractor can also represent the lessor. (emphasis added) The Postal Service established a targeted incentive for reduced lease rates but in the first year of the contract did not meet the target. In addition, facilities officials did not establish a maximum contract amount, which poses the risk of escalating contract costs. Officials increased contract funding

from \$2 million to \$6 million and, as of February 2013, contract payments exceeded \$3 million."

PROTECTING YOURSELF

When the broker's firm represents both tenants and landlords, the potential for conflicts of interest are inherently present. There is nothing startling about that statement. The dangers of self-dealing in the Principal-Agent relationship have been recognized for thousands of years.

Professor Peter Smirniotopoulos - who is at The Center for Real Estate and Urban Analysis, George Washington University School of Business - in his report, **Conflicts of Interest in Commercial Real Estate Transactions: Who Represents the Tenant?**, made several suggestions on how the real estate industry might move ahead in dealing with this conflicts of interest problem. One of his suggestions involves standards. He writes, "... there is no uniform industry practice or even acknowledged Best Practices within the CRES sector regarding the disclosure and avoidance of conflicts of interest. Short of an absolute ban on dual representation, which is the only way to prevent conflict of interest arising out of dual-representation situations, the CRES sector should consider adopting or encouraging the adoption of uniform standards for handling conflicts of interest."

The residential brokerage industry has already taken the steps to establish these types of rules and standards, which have made it easier for home buyers to better understand the positions and interests of those involved in the home purchase process.

However, taking where the commercial real estate industry stands today and understanding the conflicts that are inherent in the existing structure of that industry, doesn't it make sense when you are looking for an occupancy solution to at least consider hiring a commercial real estate broker who only represents tenants?

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