

REAL ESTATE FINANCE

Tenant Reps Tout Lack of Conflicts

Firms Focusing on Lessees Say Clients Get Better Deals By Avoiding Landlord Ties

By RYAN CHITTM

Richard Leupen is the latest to wade into the debate over the best way to represent building tenants in leasing transactions.

The chief executive officer of **United Group of Australia** cast his lot with a small sector within the U.S. commercial real-estate services market known as tenant representation when his company purchased Equis Corp. in late June for \$120 million.

Like United Group, he says, Chicago-based Equis focuses on serving occupiers of space. "Our specialty is getting a decent deal for the tenant" and minimizing occupancy costs, Mr. Leupen says. "Landlords are trying to maximize the cost."

The deal shines a light on a subset of the commercial brokerage industry that turns down lucrative landlord-representation business so it can sell itself as conflict-free, intent only on getting its clients the best deal. Firms representing only tenants, or tenant reps as they're known, say companies are best served by using them for leasing transactions because they aren't serving two masters—both landlord and tenant—as they say so-called full-service brokerage firms sometimes do.

In a typical commercial real-estate leasing transaction, a landlord employs a so-called agency broker to negotiate deals with a broker representing tenants looking for space. The landlord pays the fees—which usually total 3% of the lease value—for both brokers. The brokers representing the tenant get about two-thirds of the fees, because more work is involved in identifying companies interested in a building, and the landlord's broker gets the rest.

The fees can amount to millions of dollars because some leases run into the hundreds of millions of dollars. The potential for conflict comes when full-service brokerages represent both sides in a deal.

Full-service firms' "largest revenue stream comes from the landlord community," says Peter Hennessy, president of the New York office of Staubach Co., an Addison, Texas, tenant-rep firm founded by former Dallas Cowboys quarterback Roger Staubach. "That's where [their] bread is buttered. Which agenda will they follow?"

It's difficult to quantify how much

Deal Dynamics

Two sides of a debate over representation of tenants in commercial real-estate transactions

Tenant-representative firms say:

- Full-service brokerages serve two masters, landlord and tenant
- Full-service brokerages have incentive to seek higher rent and lower vacancies
- Tenant-rep firms have more incentive to innovate to lower occupancy costs

Source: WSJ research

Full-service brokerages say:

- Their disclosure of potential conflicts is rigorous and mitigates conflicts
- Working for landlords gives them better access to data and space that isn't public yet
- Some tenant-rep firms have their own conflicts, such as property-management arms

money—if any—a tenant-rep firm might save its client compared with a full-service firm, because agreements are often confidential and each one is unique.

Tenant reps are still the underdogs of the market, though they have been fast-growing. Staubach and Studley Co. of New York are the two biggest such firms, each with leasing and sales transactions totaling \$21 billion in 2005. CB Richard Ellis Group Inc., the largest commercial real-estate services firm by market capitalization, had about \$150 billion in transactions last year.

Tenant-rep companies say they have made their biggest inroads in the law-firm business, in part because lawyers are so attuned to potential conflicts of interest. "You'd never go to a lawyer whose firm represents both sides of the deal," says Studley President Michael D. Colacino.

Full-service firms say they disclose potential conflicts to both sides of a transaction and that transparency mitigates any problem. Moreover, they say they have access to better information from landlords—such as blocks of space coming open that haven't been made public—that can help their clients to get a leg up in a market.

Chris Ludeman, president of U.S. brokerage for CB Richard Ellis, says no landlord represents more than 1% of the company's revenue. "The concept that these landlords sway us is absolutely patently false," he says.

Last year, CB Richard Ellis worked both sides of the deal on four of the top 50 transactions in New York, says John Powers, chairman of the New York tristate region for CB Richard Ellis.

Sometimes it's the same broker on both sides of a deal, though that's rare. Mr. Powers recalls a deal several years ago where he represented Arthur Andersen, the now-defunct accounting firm,

when it was looking for a large block of space in Times Square. Andersen ended up focusing on one owned by Boston Properties Inc. that Mr. Powers represented as the agency broker.

"I had a meeting with the CEO of Andersen and Mort Zuckerman [chairman of Boston Properties] and said 'Hey, I'll do whatever you want to do. I'll get out of the deal if you want me to. I'll do whatever,'" Mr. Power says. Both sides ended up asking him to stay on, though Andersen asked him not to come to certain meetings. "As long as they know, they feel they are empowered to make a decision," he says. "It's not like I am or we are their only choice."

That's enough for most tenants, especially since real estate is still a relationship-driven business, says Will Marks, an analyst with JMP Securities in San Francisco who covers the commercial real-estate brokers. "I think the big firms where that conflict of interest exists have been able to manage it and it's been around so long that it's generally not an issue."

One Equis customer, Stanley Steemer International Inc., a carpet-cleaning company based in Dublin, Ohio, uses Equis for all of its commercial real-estate leasing in 48 states. Ryan Jankowski, Stanley Steemer's vice president and corporate counsel, says he can't keep an eye on what's happening at every property in his portfolio and doesn't want to worry about a broker whose firm represents someone with whom he's negotiating.

"We're not really big real-estate players," Mr. Jankowski says, noting that Stanley Steemer has little leverage—its properties range from 2,000 square feet to 42,000 square feet and it has just a single location in an average market. He says, "We're here in Dublin, Ohio, and I need a facility in Contra Costa, Calif. I want to have some assurance that the folks representing me have my interests in mind."