SVN INTERNATIONAL CORP.

Time's up for non-cooperation in CRE

BY KEVIN MAGGIACOMO

About the author

KEVIN MAGGIACOMO

PRESIDENT & CEO

Kevin Maggiacomo serves as President & Chief Executive Officer of SVN International Corp. and is responsible for the company's mission & vision. Propelling the company's expansion across the globe, Maggiacomo has facilitated SVN's growth from 7 US offices in 2001, to more than 200 in 8 countries today. During his 21-year tenure, SVN has won numerous awards including being named the #1 Fastest Growing Property Management Company by MHN, twice named to Inc. Magazine's list of the Fastest Growing Private Companies in America, acknowledged by the Lipsey Co. as one of the most recognized brands in commercial real estate, and twice ranked as a Top Impact Company by Real Leaders®. Maggiacomo has been named a 2022 Top Impact CEO by Big Path Capital and has been recognized as one of the Executives of The Year by CPExecutive.

Introduction

Historian Yuval Noah Harari argues that social cooperation is key to humanity's survival and reproduction. Our ability to cooperate with a large number of strangers was one of the factors in Homo sapiens winning out over other human species 15,000 to 40,000 years ago. Our ability to cooperate gave us an edge in trading, hunting and defending ourselves, as well as sharing information that helped us make sense of the world and survive.

Fast forward to today and our capability to cooperate with each other is unprecedented, thanks to the digital technology advances we've seen over the past few decades. Now, we can network and cooperate anytime, anywhere, with anyone from the comfort of our homes and offices, and with the tap of a screen on a device we carry with us 24/7.

THIS ABILITY TO NETWORK AND COOPERATE IS SO POWERFUL THAT IT HAS DRIVEN THE FORMATION OF A NEW GENERATION OF BUSINESSES

This ability to network and cooperate is so powerful that it has driven the formation of a new generation of businesses that are rethinking how we do things such as shop, travel and commute. Consider companies such as Airbnb, Alibaba, eBay and Uber. The oldest of these, eBay, was founded in 1995 and posted 2021 revenue of $10.4 billion. Alibaba, founded in 1999, posted 2021 revenue of a staggering $109 billion. The younger members of the cohort, Airbnb and Uber, were founded in 2008 and 2009 respectively, and already post revenue in the billions: $5 billion and $17 billion in 2021 respectively.

These young companies, and others like them, have become global giants by tapping into the power of the network economy. The networked nature of the economy, and these companies, manifests in several ways but they typically have in common that they increase visibility of the marketplace, they create a centralized platform, and they make it possible to buy and sell products and services that were once sold face-to-face, to a global customer base.

In this whitepaper, we argue that the CRE industry urgently needs to tap into the power of the network through true cooperation to drive shared value in the future. Today's typical way of selling CRE assets is illogical and driven by misaligned incentive structures, instead of sound economic principles. This results in money being left on the table by brokers and their clients. Further, the market has evolved beyond this incongruity, and is increasingly expecting a better way of working that effectively drives demand for sellers' properties.

THE CRE INDUSTRY URGENTLY NEEDS TO TAP INTO THE POWER OF THE NETWORK THROUGH TRUE COOPERATION

The law of supply and demand

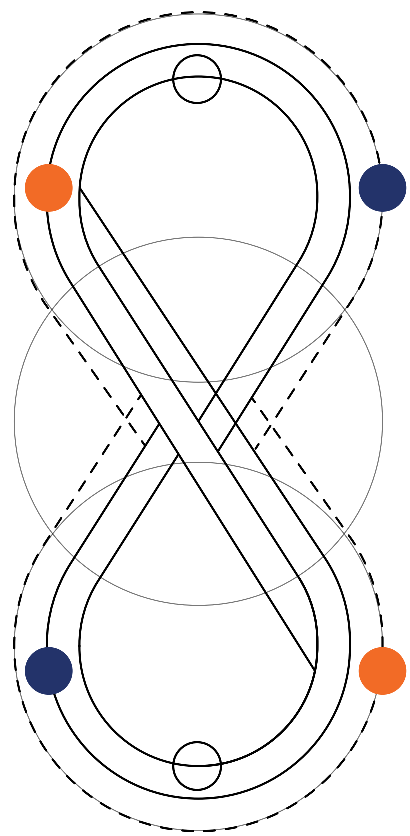
The residential real estate industry has got this. This part of the real estate world has long embraced the notion that **increased exposure to a property can boost that property's selling price**. Residential real estate brokers are comfortable with the fact that they can't possibly know every potential buyer for every property they sell. Their response is to widen the net by cooperating with a network of brokers who have relationships with buyers. They know that this approach means shared value for everyone.

This dynamic comes down to one of the essential and fundamental laws of economics: the law of supply and demand. **If the demand for a product or service is driven up, higher prices will follow**. Conversely, reduced or sluggish demand for something means lower prices.

AT SVN WE ARE CONVINCED THAT, JUST AS IN THE RESIDENTIAL REAL ESTATE MARKET, COOPERATING PROACTIVELY WITH THE BROKERAGE COMMUNITY IS THE MOST EFFECTIVE WAY TO INCREASE DEMAND FOR COMMERCIAL PROPERTIES FOR SALE

To carry this logic over to the real estate world, more offers on a property means a higher sales price for the seller. So far, so obvious, correct? The principle of supply and demand is something we all see playing out every day. Today, global supply chain issues are making a plethora of items scarce, driving up global competition and demand for those products and consequently resulting in higher prices.

At SVN we are convinced that, just as in the residential real estate market, cooperating proactively with the brokerage community is the most effective way to increase demand for commercial properties for sale. Empirically, this plays out in practice time and again.



Leaving money on the table

REAL CRE DEALS THAT SHOW COOPERATION WORKS

Deal 1:

The sale of a retail center outside of Portland, Oregon in 2021 saw a winning bid that, at $18.9 million, was 12% higher than the competition. The buyer was introduced to us by a residential broker that we were cooperating with. They were a high net worth individual, and this was their first foray into CRE investment, so were not previously listed on any CRE database.

Deal 2:

In a 2021 sale of a low-rise office building in rural north-western Illinois, we doubled the selling price of the property thanks to the introduction of a buyer by a broker we cooperated with. Doubling the sale price from $1 million to $2.05 million was a huge win for our seller.

For the most part the CRE industry resists brokerage cooperation and fee sharing. A study we carried out spanning 10 years and 10 states showed that only one in six of the 15,000+ CRE deals surveyed was clearly cooperative*. Instead, in almost 85% of CRE transactions, listing brokers do not market to other brokers at all, miss out on all their relationships, and wind up producing the buyer on their own – referred to as a "double-ended" deal.

Indeed, today most brokers do the exact opposite of the companies mentioned earlier. Instead of tapping into the power of the network and distribution channel of the industry (i.e., the 100,000 brokers who exist within it) through cooperation, they actively work to shut this down, only exposing their sellers' properties to a fraction of the potential buyers in the market. Looking at this through the lens of the supply and demand principle, this means that demand is reduced, sales prices are unlikely to be optimized, and will certainly not result in a fair, achievable, market rate. Undoubtedly money is being left on the table by both CRE brokers, and more importantly, their clients.

What is driving this clearly illogical behavior by the CRE industry? In an industry where you eat what you kill, surely any opportunity to drive up the sales price should be eagerly grasped? A happy seller means a long-term relationship and more deals down the line.

However, the undeniable logic of supply and demand goes head-to-head with a misaligned incentive structure. Far from ensuring that listing brokers and their sellers are on the same team, the current incentive structure puts them at loggerheads. And further, it disincentivizes cooperation and the ability to reach accurate, fair market prices more often and more easily, thanks to the power of the network.

MONEY IS BEING LEFT ON THE TABLE BY BOTH CRE BROKERS, AND MORE IMPORTANTLY, THEIR CLIENTS

** The 9.6% report: A report on the pricing advantage of cooperation*

The unfortunate power of misaligned incentives

This behavior indicates that when the principle of supply and demand meets the force of misaligned incentive structures in a commission-only environment, the latter wins out. This happens in two main ways.

WHEN THE PRINCIPLE OF SUPPLY AND DEMAND MEETS THE FORCE OF MISALIGNED INCENTIVE STRUCTURES IN A COMMISSION-ONLY ENVIRONMENT, THE LATTER WINS OUT

Incentive disconnect 1

With no base salary to fall back on, brokers need to be clever when it comes to how they spend their time. Any increase in seller price, although of great importance to the seller, only translates into an incremental increase in the money in the broker's pocket at the end of the deal. Take a $5 million commercial sale as an example. If you assume a 4% commission, it is clear that if the listing broker hustles hard and achieves $5.5 million instead, they only gain $20,000 in additional commission. To be sure, the $480,000 added to the sale price is significant for the seller but does the slight gain in commission ($220,000 vs $200,000) make sense to a broker, who could be using that additional effort on a new deal altogether?

Clearly this structure does not incentivize brokers to get the best possible deal for their seller, no matter how long it takes and how much effort is required. In other words, **brokers are not motivated to drive the maximum possible demand for each property**. Instead, this structure incentivizes brokers to get a good enough deal by spending the least amount of time, money and effort, and to move on quickly to the next deal.

(Top tip: if you haven't already, dig out a copy of Steven D. Levitt and Stephen J. Dubner's book Freakonomics to read their data informed discussion about how this incentive misalignment plays out in the residential real estate market. Their final takeaway is that the data shows that real estate agents do not sell their own properties in the same way they sell clients' properties. When it comes to their properties, they spend the time creating demand and hold out for the best deal.)

Incentive disconnect 2

No doubt, when asked, some brokers will claim to cooperate with other brokers. But if this cooperation is little more than a referral fee it creates yet another misaligned incentive situation. This is because, yet again, the monetary reward does not match the amount of effort required to earn it, and brokers representing buyers are better off spending their time elsewhere, connecting their motivated buyer to a seller where the deal offers them more than 25% of the commission fee.

What does cooperation look like?

If the above scenario is not cooperation, what does true cooperation look like? In our world, cooperation is an all-in situation. It starts with an equal split of the commission between the listing broker and the buyer's broker, but extends beyond this.

TRUE COOPERATION IN THE COMMERCIAL REAL ESTATE WORLD HAS TO BE:

1. A 50%-50% COMMISSION SPLIT BETWEEN BUY AND SELL SIDE AGENTS
2. COMPANY POLICY
3. ORGANIZATIONALLY LEVERAGED: EVERYONE HAS TO DO IT ALL THE TIME TO CREATE AN EFFICIENT MARKETPLACE

What do SVN® franchisees say about cooperation in CRE?

“*Our cooperative culture and business model means we can cast a much wider net and drive value. It has definitely increased our market presence and opened doors to more opportunities. This is something we embed in our team early, starting with the onboarding process, and our advisors believe in the value it creates.*

Nolan Julseth-White, CCIM, Managing Director,
SVN | THE EQUITY GROUP

“*The value of a cooperative culture and business model is invaluable! I've been in this industry for two years at four different firms, and I've had my best income producing years since we started our SVN franchise in 2018. In fact, talking about the SVN culture of collaboration at listing presentations has definitely played a part in landing listings.*

Janet F. Kramer, JD, CRRP, Managing Director,
SVN | INSIGHT COMMERCIAL REAL ESTATE ADVISORS

“*Building a business with a foundation of cooperation and collaboration strengthens relationships both within and outside the office, increasing communication and deal flow. We regularly attract dozens of offers on listed properties because the brokerage community knows there is a fair fee attached to our listings. In addition, it means we can hire top talent that is attracted to the cooperative model where they can be a part of something bigger than just themselves or their team.*

Perry Laufenberg, Managing Director,
SVN | DESERT COMMERCIAL ADVISORS

Why now?

Despite this systemic disconnect, the CRE industry is not in bad shape, you might argue. Indeed, the real estate industry was a top three contributor to the uptick in the US's GDP in the fourth quarter of 2021**. Why change an apparently winning formula, and why now?

The two main reasons – that your clients will demand it and that technology will make it inevitable – are closely intertwined. While the CRE industry has been temporarily immune to this and other global trends, this won't last forever as expectations change.

The broker of the future is going to be driven by a more informed client, who is armed with real estate data that they simply didn't have access to a decade ago. Now and moving forward, clients will have the ability to profile and understand a CRE market from 3,000 miles away, or from the other side of the planet. The broker that doubles down on a matchmaker role is going to be usurped by the broker who understands that clients have unprecedented access to data, and what they really need is someone who can make sense of that data to drive actionable information and insights that no one else has. Meanwhile, the matchmaker role is inevitably going to be automated.

What's more, clients intrinsically understand the power of a network. From hiring, to booking holidays, to shopping, to commuting, people tap into the networks every day. They're not going to be convinced that a single broker's database will magically produce the perfect buyer for their property compared with the reach of a network of brokers and their distribution channels. Furthermore, the profile of CRE buyers is changing, with more foreign direct buyers, international investors and first time CRE buyers than ever before. Clients of the future will demand broker cooperation and the generation of organized competition through fee sharing to get the best deal at the best terms for their properties.

THE BROKER OF THE FUTURE IS GOING TO BE DRIVEN BY A MORE INFORMED CLIENT

** BUREAU OF ECONOMIC ANALYSIS, US DEPARTMENT OF COMMERCE

What you need to know

The clock is ticking on what is a systemic issue in commercial real estate investment sales. Misaligned incentives create a loophole where brokers' interests take precedence over sellers' interests, resulting in a situation where most sellers are selling for less than fair market value. This model and way of doing business is causing sellers to leave money on the table.
Savvy brokers have the chance to embrace efficient, modern, and informed ways of working to achieve the best price and the best terms for their client. We should know, as SVN was founded on the basis of these principles in 1987 and have been working like this for 36 years.

IF YOU'RE INTERESTED IN LEARNING MORE ABOUT THE POWER OF COOPERATIVE BROKERAGE, VISIT WWW.SVN.COM

About SVN

The SVN® brand was founded in 1987 out of a desire to improve the commercial real estate industry for all stakeholders through cooperation and organized competition. SVN is now a globally recognized commercial real estate brand united by a shared vision of creating value with clients, colleagues and our communities. When you choose SVN, you mobilize the entire SVN organization of experts and all our trusted relationships to act on your behalf. This shared network is the SVN Difference. To learn more, visit our website, **www.svn.com.**