September 2005 Newsletter

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This is an article written to help unravel the myths behind commercial real estate investment sales, what your broker doesn't want you the owner to really know...

Commercial Properties for Sale

Myths that Sellers should know that your broker won't tell you!

There are 2 major myths regarding commercial real estate sales and investment sales in particular, that any owner/seller should know.

Before we get into the "myths" let's start with two facts about investment real estate...

Investment sales can sell themselves in the sense that there are investors willing to pay a certain price for a property based upon an economic return they deem appropriate for that asset. The real role of the "broker" is to "market" the property to achieve the best possible price in the shortest period to a buyer that has the financial ability to close on the transaction.

There are two (2) current marketing trends among many of the commercial brokers that arguably lower the amount the property seller could receive in any given deal. This is due to the over heated nature of the commercial market, which is really exposing the bad practices or lack of marketing know how of those commercial brokers that are engaged in these practices.

Myth # 1

Brokers have convinced their property owners that putting buildings up for sale without an asking price is a smart and savvy marketing technique. Many investors will not even look at such properties, as it's a game they are not willing to play. Sure, the argument you will hear is "why should we list a price, we will just shoot ourselves in the foot and get less money than we asked for?" "Let's have the interested parties bid against each other, and that way we will get the highest price".

No Asking Price Means Bid Low! Be Careful...

That makes no sense at all. First of all, if the property is priced ***CORRECTLY*** then it won't be an issue. Most agents have no idea how to properly price a property. The easy way out is to put a property on the market for sale without a price. The broker must have had a discussion with their seller who hired them as to what the price expectations should be within a certain range (lower than they think it will sell for). Truth be told, unless the owner says there is no asking price, the broker's listing agreement must have a listed price for the agency agreement to be valid.

Therefore if and when purchase proposals come in, the bid idea was good if the offers come in higher than the expectations. However, human nature dictates that without a target price, the tendency is to "bid" low. If there is no asking price the buyer has no benchmark in which to gauge their offer, and would be afraid they will be offering too much. Just as the seller is afraid to leave any money on the table so is the buyer. If sellers are seriously looking to create a bidding situation then hold an auction.

At non real estate auctions the bidding will start low and the auctioneer will try to get higher bids, usually in increments. Putting properties up for auction has its own set of potential issues but that is for another newsletter.

Avoiding The Blame Game

Another reason the brokers don't publish a price is that the investment market in commercial real estate is hot. Brokers don't want a property to sell too fast with a price they quoted, as the seller may think the property was under priced, and thus sold too quickly. This thinking is flawed in the respect that it shows a total lack of confidence in the broker hired to sell the property by the owner. Why was the broker hired in the first place?

If a seller thinks a broker undervalued their asset, that broker will never be hired by that seller again or referred to another seller.

Time is money

The fact is that time is the usually the enemy of any deal. In today's environment, the world is a different place than just a few months ago. Interest rates are on the rise, the Federal Reserve is being extremely cautious of the lender's underwriting policies, the constant talk in the media about a market bubble, and so forth. In fact the housing market has already begun to cool, which is a precursor of the commercial market. Lastly, buyers don't want to buy at the perceived "peak" of the market.

A property correctly priced should sell quickly and let's not forget the time value of money! You can always look over your shoulder and second guess yourself, especially in a hot market. In addition, having an asking price in a "hot" market allows a potential buyer who really wants to buy the property and knows there may be competition for it, to offer a percentage over the asking price. The investor also knows the seller is serious about selling.

What if I paid too much?
What Happens?

In normal markets if a property sells within 5%-10% of the asking price, this means the property was priced right. In a heated market if a property can get 15%-20% over the asking price, the seller is doing very well. The likelihood is that the majority of buyers won't go much beyond that premium. On the other hand if you get a buyer that "bids" an extremely high price that gets accepted, the chances are the buyer will understand this in short order and find ways to either back out of the deal or retrade the deal, which in either case hurts the seller. Remember most deals are financed which will require an appraisal.

When an appraisal reflects a price less than the agreed upon premium price, the buyer will typically have to put more equity (cash) into the deal or seek additional more expensive financing. This could kill the deal or have the price re-negotiated downward. Again what has happened is the owner's best interest is not being served. What good is getting that great price if the buyer can't or won't close?

After a deal is lost the last thing an owner wants to do is go through the sales process all over again. The seller will also be at a disadvantage as the market will know the owner was unrealistic in the first place and now any other buyers will perceive the owner has hungry for another deal and offer even less than they would have initially.
The bid process works for high priced trophy buildings like the Met Life building in NYC that sold earlier this year. There are only a handful of investors that would and could purchase it, so they bid against one another for "bragging rights" to the trophy. On most other deals, especially for small and medium sized buildings, having a bid process shrinks the number of investors and can lower the amount the seller gets on the sale.

Think of investment sales in terms of housing for a minute. If there is a house available in a highly desirable location, and it's listed even above the going market rate, if there are multiple parties interested in the house, guess what, the house will most likely sell for more than the asking price. Investors would do the same if they wanted a building really bad. Doesn't the seller gain if this happens? Where's the price markup on sealed bids? If you have no idea who or what price you are bidding against, isn't it the tendency to bid lower?

Another example would be a company going public with an IPO. The underwriters set a price before being offered in the open market and investors bid on it. Even Google, which had a much different IPO than most new stock issues, had a minimum bid price before investors could buy. Lastly, how serious can a seller be perceived if there is no asking price?

A collateral issue to this methodology is when the brokers make other brokers execute a confidentiality agreement for ***vacant buildings*** and still call the property an investment. What is confidential about a vacant building with no asking price, which can be found on their websites with all the property's physical features presented? Confidentiality agreements are to protect the owner as it regards their proprietary information about their tenants or the information about the building's expenses and perhaps other pertinent reports such as environmental and engineering.

Myth # 2

Commission Splits Help Make the Deal

The second major issue is that many brokers hired to sell a building today will not share or split their commission with a cooperating broker. If I am the seller, why should I care if my broker has to split their commission? You pay a commission to get the marketing expertise to get your property sold. If the broker can obtain a buyer without the help of an outside broker then great, more commission for them as I am sure the seller could care less. Of course in some cases sellers will want their broker to reduce their commission rate a little believing the broker is still getting more than if they co-operated on the deal with another broker.

A smart seller would require a broker to split his/her commission. The fact is having more brokers presenting the investments to their client(s) means more potential buyers. It's Economics 101, supply and demand; the greater the demand, the higher the price.

Another perceived reason brokers are not splitting their commissions it's because of a fallacy that really needs to be talked about which is the "relationships" brokers have with buyers, i.e. a broker's list of potential buyers. "Why should I split the commission when you are bringing me buyers I already know?" Maybe yes maybe no.

If the property is put on the open market, everyone has access to the information. Moreover, if brokers cooperated and split commissions, all brokers would be sure to let their clients know of the building that is being sold. The reality is most brokers will offer the property to "their" list of potential buyers before the building's availability is made public. Therefore, they more than likely should have reached their known universe of buyers before it is offered out in the general market. The fact that "their" buyers haven't stepped up should mean they should be more than happy to cooperate with another broker and split the commission. Or did they tell the owner they were such great brokers, and the need to cooperate wouldn't be necessary, as they will find the buyer directly, and agreed to a "low" commission rate in order to gain the right to represent?

So Your Broker Knows All The Buyers?

Brokers should be cooperating, as investment sales generally don't take a long time to sell if priced correctly, especially in a hot market like the DC/Metro area. Not splitting a commission on a property that sells itself does not make someone a master auctioneer or even a good broker, it makes them selfish and out for themselves, and not working in the best interest of their client and not doing their fiduciary duty. It is a proven economic model that transparency in a market creates the greatest value for what is being sold.

With the wide use of the Internet in today's commercial real estate industry, and the fact we are part of a Global economy, if not at least a National marketplace, it is inconceivable and totally arrogant that a broker today thinks they have access to all the probable investment buyers. So why hide behind no sales prices and confidentiality agreements which just slows and complicates the whole process....or maybe that's what your broker wants to do in order to mask the reality of their lack of marketing expertise and market knowledge.

Why Not Just Do It Yourself?

If you are an Owner selling your building without an asking price, why hire a broker at all? Simply put your building on ***Loopnet*** or ***CoStar***, or take out ads in the ***WSJ*** or ***Washington Post*** or any other public forum, and see what offers come in. Offer the brokers a full commission if they bring and close an acceptable deal...you'll be seeing many more offers than having an exclusive agent. Oh, but you don't have the expertise to negotiate a deal, who is looking out for your interest; you don't have the time to devote that is needed to sell your property...etc. OK then hire the broker to stand in for you but make sure they split the commissions. Having owned commercial real estate as a commercial broker with partners, we used to offer "full" commissions to cooperating brokers, and we had a consistent occupancy level of 95% for over 15 years. Think about which approach works best and makes the most sense.

The reality is brokers are needed to help sell buildings because of their "marketing" expertise and their knowledge of the market, meaning who are the potential buyers, and how to qualify them, which other brokers have a good track record in investment sales, what are the property values and how to best negotiate a deal etc.

As an owner, don't settle for letting brokers off the hook easy. Make the broker you choose to market your building earn his/her commission.

Proper Marketing Gets Results

Marketing is more than putting together facts, figures and building photos along with assembling the financial information and sending it out. It's about how to maximize the property's value for their client by being knowledgeable and skilled enough to get a good deal for the owner in the shortest time possible.

Lastly what happens if there are no offers? Then what?

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Next Issue....*How wrong is it to not include asking prices on space for lease?*

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