# HOW COMMERCIAL REAL ESTATE GIANTS CAN PUT TENANTS' HARD-EARNED DOLLARS AT RISK

The largest firms may not have the tenant's best interests in mind.

By Gail Corder Fischer

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# EXECUTIVE SUMMARY

In the commercial real estate world, selecting one of the largest firms for space acquisition needs may not be the safest bet for companies that need a true advocate and partner. The "Big Four" – Jones Lang LaSalle, CBRE Group, Inc., Cushman & Wakefield, LLC, and Colliers International – represent both landlords and tenants, creating a conflict of interest that can work to the detriment of tenants. While "Chinese Walls" have been put up to try to avoid this, the basic laws of human behavior render attempts at separation almost impossible. In the end, the tenant risks losing both money and any fair chance at securing the best deal possible. When dealing with large companies, millions of dollars can be at stake. This white paper will explore why tenants/occupiers should address organizational conflicts of interest and how to maintain benefits the "Big Four" offer, yet still protect their best interest and minimize costs when acquiring space.

This may be a strong comment, but commercial real estate has a spreading cancer and it's called "organizational conflicts of interest." It occurs during lease negotiations when one of corporate America uses a firm such as Jones Lang LaSalle (JLL), CBRE Group, Inc. (CBRE), Cushman & Wakefield, LLC (CW) and Colliers International (CI), otherwise known as the "Big Four," to represent their space acquisition needs. These firms follow the money, like any business. However, a large majority of "Big Four" revenue comes from acting as and/or serving owners, investors, developers and landlords. Quite frankly, they will usually have much greater interests in getting the best deal for landlords than in helping tenants minimize costs.

In this paper, we'll explore conflict of interest issues across various industries, which are also applicable to corporate real estate, and explore the influence "following the money" plays, highlighting the very real potential of a negative impact to a tenant's bottom line.

We'll offer definitive behavioral proof that there is no reform, technique or persuasive argument that can change human behavior, whether intended or unconscious.

## Do "Chinese Walls" work?

For decades, Wall Street has used "Chinese Walls" as barriers to prevent certain activities such as insider trading. This tactic to address illegal activity has proved to be problematic.[1]

Attempts to address the issue have led to legislation such as the Sarbanes-Oxley Act (SOX) of 2002, which introduced major changes to the regulation of corporate governance and financial practices.[2] What followed was the financial meltdown of 2007-2008, resulting in additional measures including the 2010 Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank).[3]

Unfortunately, "Chinese Wall" techniques remain flawed, as demonstrated by the ugly financial mess of recent years. On Wall Street, underwriters and analysts were meant to stay separate, but, in reality, bankers and brokers engaged in abuses, sharing of data, lack of controls, and downright criminal activity, costing 90 million Americans a $7 trillion loss in the stock market.[4] **Sadly, corporate America, the government and the taxpaying public all continue to expend tremendous public and private resources to mitigate the costs of organizational conflicts of interest.**

**Just like Wall Street's agency-broker conflicts, when real estate brokerages represent both tenants and landlords, an organizational conflict of interest exists, and it has the potential to cost a tenant millions of dollars.**

Just like Wall Street's agency-broker conflicts, when real estate brokerages represent both tenants and landlords, an **organizational conflict of interest** exists, and it has the potential to cost a tenant millions of dollars. While dealing with space acquisition needs, how can one justify a "Chinese Wall" scenario? Smart corporate real estate executives are turning to tenant/occupier-only firms for representation of space acquisition needs to ensure their needs come first versus the landlord's.

## Real Estate Control Power Play... who do the big firms really answer to?

We are seeing a power play for the control of real estate and the real estate fees that come from the lucrative cycle of buying, financing, managing, leasing and selling of real estate assets. Higher rental rates help ensure this cycle's success and repeatability as the playground for yield-hungry institutional investors. Large firms that represent landlords and tenants – the "Big Four" are most definitely part of the issue.

In fact, BlackRock, the largest financial asset management company in the world, was featured in a July 2014 Fortune article which stated, "The question of how much power BlackRock draws from the multitudinous shares it has to vote – and then how it chooses to use power – is complex." The article further states that BlackRock has 4.3 trillion of assets under management,[5] and according to proxy statements, it currently owns 8.4 percent of JLL[6] and 5.2 percent of CBRE[7].

In other words, that's a whole lot of power with only a "Chinese Wall" for separation in an industry with little regulatory control. According to a report in The Sydney Morning Herald, TPG Capital, one of the largest global private equity investment firms, intends to purchase Debenham, Thouard, and Zadelhoff (DTZ), a global leader in property services. The article states, "TPG wants to take advantage of DTZ's footprint in China" and also intends to acquire privately-owned commercial real estate firm Cassidy Turley "to build a global property group that can rival US-based market leaders CBRE and JLL."[8]

The long and short of the matter is that BlackRock, and the like, hold the votes and the cards, and the escalating game is answering to shareholders on yields from asset management and private equity investment portfolios. **It's a gamble for a company to put its corporate real estate portfolio in the hands of giants that serve multiple masters, and whose coffers have more to gain by supporting the best deal for landlords rather than helping tenants minimize costs.** Further proof of the tenant-occupier as the sacrificial lamb is seen in recent headlines, published studies, lawsuits and legislation.

## Robust disclosures – what purpose do they serve?

In early 2014, Investment News reported that the SEC was examining advisors that represent multiple players as a source of potential conflicts of interest. Mark Costley, a partner with the law firm of Drinker Biddle & Reath, commented on these types of advisors, saying "We're seeing a continued focus on conflicts of interest and the variety of ways these conflicts arise. Another potential conflict area that the SEC is emphasizing again – dually registered advisors – could have broad impact in the industry." He further discussed being "mindful of…identifying conflicts of interest…and whether an agency has made robust disclosures."[9]

While Costley speaks to the uncertain future of such conflicts, like many others he touts a "Chinese Wall" solution with full disclosures as an acceptable practice to address the problem. But, isn't disclosure just an attempt to distance oneself from the potential liabilities?

**As companies wrestle with how to manage their corporate real estate, the question remains whether they are ready to put a stop to conflicts of interest and put their own best interests first. By engaging an exclusive tenant representation firm for their space acquisition needs, companies can prevent more calamity and ensues.**

## Auditors struggle to control biasing influences.

In a Harvard Business School Working Paper, Harvard University and Carnegie Mellon University researchers conducted three experiments that focused on judgment and psychological processes of auditors whose analysis and conclusions are crucial in allowing investors to determine the financial health of a company. A conflict of interest arises when auditors are paid by the companies they audit. Just as the "Big Four" have greater interests representing landlords than in representing tenants, the experiment showed that being critical in representing both sides of a financial picture is a tough choice. **Judgment and actions are seriously swayed because they may result in the loss of an account and vital revenue, like the recurring revenue that the "Big Four" earn from deep relationships with landlords and their vast holdings.**

In the paper, the authors concluded, "Our results suggest that problems of conflict of interest are more profound than is commonly assumed. It is not enough to be conscientious and consciously counteract potentially biasing influences on judgment, because people may simply not be able to adequately correct for biasing partisan influence."[10] No "Chinese Wall" solution, however well intentioned, can offset human nature and the costs that taking these risks potentially impose.

## Conflicts of interest accepted as industry norm ...say it ain't so!

CoreNet Global, commercial real estate's leading trade organization, published highlights from its 2010 Global Asia Summit in an article titled "Landlords & Tenants: The Fight Club?" In the article, Nigel Smith of CBRE confirmed what's at stake by saying, "...property agents are making matters worse for everyone by not being up front in representation issues. Some agents attempt to get the best of both worlds by trying to make both landlords and tenants think they are working for them." Smith further noted that "this behavior is particularly bad news for landlords, since they are the ones who most often pay the fees and are at least owed better treatment as a result." Smith failed to make the connection that it is the tenant's rental stream that enables landlords to pay these fees. According to the article, response to this was that "it's simply a case of following market norms."[11]

Now, let's compare these norms with those in the legal sector. According to the Texas Disciplinary Rules of Professional Conduct, Texas Bar, Rule 1.06 (a) states "...A lawyer shall not represent opposing parties to the same litigation..."[12] New Jersey law states: "...the same lawyer cannot be on both sides of a commercial real estate sale, even with waivers..."[13] Additionally, judges must recuse themselves from cases with even the slightest relationship connection. Reconsider Smith's comments. If organizational conflicts of interest aren't acceptable on Wall Street or among lawyers, then they shouldn't be accepted in corporate real estate.

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# CASE STUDY 1

## Were U.S. Postal Service properties undersold?

In 2013, the U.S. Postal Service Office of Inspector General (USPS OIG) reported "concerns" regarding a contract awarded to CBRE for real estate management services. The USPS OIG was tasked with making sure USPS was effectively using its limited resources and found "conflict of interest concerns... the contractor (CBRE) acts on the behalf of the Postal Service in negotiating leases and the contractor (CBRE) can also represent the lessor." In the end, oversight was less than adequate and contract costs well exceeded expectations, putting the USPS at risk.[14]

At the same time, award-winning investigative journalist Peter Byrne wrote a book entitled "Going Postal," which offered an in-depth study of public records and sources on the sale of USPS properties. The book is a disturbing tale of CBRE's repeated violations of its exclusive contractual agreement with USPS to sell an $85 billion real estate portfolio at or above fair market values. Byrne followed Richard C. Blum, CBRE company chair and husband to U.S. Senator Dianne Feinstein of California. He wrote of long-suspected wrongdoings, even subtitling his book "U.S. Senator Dianne Feinstein's husband sells post offices to his friends, cheap."[15] Previous investigations uncovered no evidence, yet Byrne's yearlong investigation yielded multiple conflicts of interest and problems with USPS sales supervised by Blum's company.

In details presented in the chapter "Following the Money," Byrne showed that from June 2011 through May 2013 CBRE sold 52 postal properties for $166 million. The total assessed value of this portfolio at the time of sale was $232 million, even accounting for lower fair market value for distressed properties, shortages of commercial real estate available in developed areas and/or demand pressures. He then subtracted out the nine properties that sold at a value higher than the assessed value and concluded that CBRE had undersold its postal real estate portfolio by at least $79 million. He added that CBRE undersold these properties even as the price of commercial real estate, especially for central downtown parcels, was approaching the pre-crash highs of 2007, as evidenced by Moody's/RCA Commercial Property Price Index (Dec 2000=100).[16]

# CASE STUDY 2

## How JLLs involvement with State of Tennessee leads to legislation

In November 2013, Nashville's CBS affiliate reported on its investigation of JLL's handling of state buildings and a contractual agreement signed by Governor Bill Haslam's administration. The story reported on the costs to taxpayers arising from JLL's recommended moves. Specifically, the report talked of JLL's recommendation to demolish the Cordell Hull state office building and sell off four other state buildings. JLL was paid for the advice and the State Building Commission had already approved $2.7 million for JLL to negotiate five leases for new space.

Additionally, Haslam's administration agreed to pay JLL another $1 million to supervise the decommissioning of the state buildings. Tennessee State Representative Sherry Jones commented, "We're moving people around just so JLL can make money. It's a serious conflict of interest – serious. With all the problems that [the Department of Children Services] has and continues to have, we're going to move them into a building that's not efficient enough for the Capital Lottery to work in, but it's gonna be okay for DCS."[17]

These allegations led to two bills being introduced – State Bill 1447 to ban the state from contracting with companies that have organizational conflicts of interest and State Bill 767 which requires the state's Central Procurement Office, the State Building Commission and the state Department of Transportation to "establish policies and procedures to define and identify organizational conflicts of interest." The latter was signed into law on April 24, 2014.

## Can corporate directors mitigate conflicts?

A University of Illinois Law Review article entitled "Unconscious Bias and the Limits of Director Independence" offers a look at how actions and decisions can be influenced by such factors as family, friendships, favors, experiences, history, etc. After the scandals and corporate collapses in 2001-2002, Congress, the SEC and the stock exchanges set up rules to moderate a company's board of directors to be independent. Although directors believed themselves to be following mandates and acting in good faith, unconscious factors continued to affect behavior patterns and decision-making unintentionally. The article stated, "It will come as no surprise that people are also biased by group loyalties, friendship, and non-pecuniary self-interest. Indeed, such biases might matter little if directors, acting in good faith, could identify and control them. Frequently, however, the director can neither identify nor control biases.

> **"Eliminating partisan allegiances may be the only way to eliminate conflict of interest."**

Recent psychological research demonstrates that people are often unaware of their biases and, more importantly, how their biases affect their decision making." The article goes on to say, "...although people may be aware of their vulnerability to bias, they tend to underestimate it, and do not adequately correct for it when called on to do so. **When a particular interpretation of the evidence will benefit them materially, people gravitate toward that interpretation, even when they hold an explicit goal of being impartial."**[18] Human nature dictates behavior, regardless of conflict awareness, preemptive disclosures, regulations, barriers, or restrictions. In commercial real estate, the affects can be devastating. Back to Harvard's paper, it concludes "Eliminating partisan allegiances may be the only way to eliminate conflict of interest."

# THE CURE IS EASY

It's no longer true, if it ever was, that the breadth and girth of a "Big Four" company is always in the best interest of corporate America. A "Big Four" company is great for facilities management where it can offer massive purchasing power benefits and operational scale. However, that market dominance could become a liability when one represents the tenant and is also the landlord or owner. It's not that people or big companies intend to mislead, but given the unconscious biases, unintended consequences and unknown unknowns, it's a reason for concern.

There is, however, a simple two-step solution for tenants. Tenants have the power to **remove the landlord bias altogether** by (1) placing any owned facilities management outsourcing with a "Big Four" firm; and then (2) outsourcing space acquisition needs to a conflict-free tenant representation firm that is unequivocally focused on the tenant. Some tenant-only firms bring elite teams and an actual "feet on the ground - anywhere" presence that are keenly focused on a tenant's specific needs for a particular transaction.

Today's tightening markets beg a better solution: **Change the dynamics in your outsourcing practices and secure the greatest opportunity to get space at the best rate, terms, conditions and flexibility a market can bear.** Real estate is one of the largest expenses on income statements for corporate America – isn't it time to protect the bottom line?

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## TENANTS DESERVE REPRESENTATION WITHOUT CONFLICTS.

## RETHINK OUTSOURCING.

> **"Technological advancements empower us with capabilities that were out of reach only yesterday. The most successful real estate organizations in the years ahead will be the ones that embrace technology, maintain its pace, and convert its advancements into additional client benefits."**
>
> Gail Corder
> National Real Estate Forum, 1993

## About Fischer

Fischer is a leading global corporate real estate firm that provides consulting, brokerage and technology solutions to corporate real estate users looking for a conflict-free broker for their real estate needs. Founded in 1985, Fischer helps clients get the most out of their real estate portfolios and activities by applying its in-depth knowledge of strategic influences to decisions that impact every aspect of their business.

As exclusive tenant representatives and corporate real estate consultants for many of the world's largest companies, Fischer delivers results through deep expertise in portfolio management, strategic planning, acquisitions, dispositions, project management, transaction and construction management, capital markets, sale-leasebacks and technology.

## About Fischer Technology

Fischer is a leader in technology innovation. Always on the vanguard as a pioneer in game-changing technology, Fischer has deep IT expertise that enables cohesive, consistent and seamless service delivery to our clients.

Fischer's IT background and expertise in developing strategically-conceived data aggregation and analytics helps companies solve complex business challenges and form dynamic, end-to-end management solutions with a best-in-class visualization interface and brilliant action-ability. Fischer real estate portfolio management solutions, including ManagePath 8.0, the industry's leading lease administration software, allow companies to elevate their decision making to game-changing levels.

## About the author

Gail Corder Fischer is the Vice Chairman of Fischer and President of FischerMSI, a WBENC-certified affiliate, headquartered in Dallas, Texas. She's been recognized as a "Top 50 Women in Commercial Real Estate" nationally, and has advised on real estate matters since 1982. Corder Fischer is a long-time member of CoreNet Global, the U.S. Chamber of Commerce and is also very involved with communities personally and professionally through her philanthropic work and volunteerism.

Corder Fischer co-leads Fischer to be the dynamic and strategic outlier in tenant representation and corporate services. "Everything about us, is about you – the tenant of corporate America." This is why companies including FedEx, Alcoa, IBM, DuPont, Dow Jones, GM and many others have remained Fischer clients over the last 29 years.

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[16]Byrne; Going Postal... U.S. Senator Dianne Feinstein's husband sells post offices to his friends, cheap, (© 2013 Peter Byrne/Byrne Ink; e-book http://amzn.to/19owuse)

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