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We Ain't Seen Nothing Yet

SIOR Technology Study sees more changes coming in the way brokers operate, deliver services and get paid.

Few tears have been shed in the commercial real estate industry over the collapse of the "Internet Economy."

Oh sure, there's been some grumbling over unexpected vacancies and dumped sublet space, maybe even a little heartburn over some failed investments. But sorrow? Regret? No way.

For most rank-and-file practitioners, the sensation of reading about another failed dot-com is more akin to sweet vindication, re-affirming their long-established way of doing business and providing a well-deserved comeuppance to the bravado of certain Internet company execs who espoused a "We will bury you" attitude toward their bricks-and-mortar counterparts.

Having been told numerous times that their days as market intermediaries were numbered, to be replaced by "frictionless" digital marketplaces, the brokers viewed new technology as a threat. But the threat quickly faded and the brokers eventually collected commissions for re-leasing the space formerly occupied by the dot-coms.

So brokers may be understandably skeptical when another study on the impact of technology on commercial real estate comes out and predicts "sweeping changes" affecting the "fundamental business model of commercial brokerage."

Yeah, right. Haven't we heard this before?

Nevertheless, this latest study by the SIOR Educational Foundation, called "The Impact of New Information Technologies on the Commercial Brokerage Industry," carries with it a certain degree of credibility. For one thing, the research was conducted under the auspices of SIOR, a respected industry trade group, not by some "emerging-technology" research firm hoping to get hired as a consultant.

Its authors, Joseph Gyourko and Asuka Nakahara, are director and associate director, respectively, of the Zell/Lurie Real Estate Center at The Wharton School of the University of Pennsylvania, both respected academics with long-time ties to the industry.

Further bolstering its case, the study's findings are not nearly so radical or sweeping as compared to the previous claims offered by every run-of-the-mill technology start-up. Instead, it identifies several intriguing yet modest changes, the signs of which are already evident in the market.

Therefore, it appears the value of the study lies in confirming those changes already underway and expected to impact the market first, rather than from revealing any startling new insights.

In examining how information technologies will "materially influence the existing operations of traditional brokerages," the study identifies three broad areas of change:

Change #1: How Brokers Are Compensated and Brokerage Firms Are Staffed

Not surprisingly, in examining the ways in which information technologies will "materially influence the existing operations of traditional brokerages," the study sees alternatives developing to the industry's long-held, commission-based compensation structure.

Pressure to reduce or replace commissions with other compensation structures is largely the result of technology making the real estate marketing process more "transparent" to clients, the study claims. Not only will this affect how a broker is compensated, but also result in changing roles for personnel and different sets of skill and capabilities within a brokerage firm.

"The basic way in which brokerage services are priced will change," the study reports. Brokers will be compensated more like consultants and attorneys, it asserts, with project-based fixed prices becoming more common as well as fee-per-hour billing arrangements.

Furthermore, the study predicts changes to the compensation structure will most likely occur among the tenant rep and project leasing sectors, leading to lower growth or even reduced commissions in those sectors, while leaving investment sales and corporate disposition areas firmly entrenched in commission-based compensation arrangements for now.

The use of new technologies will also lead brokerage firms to restructure or reallocate personnel, with staffing duties and compensation arrangements again mirroring consultant and law firms where partners are generally divided between "rainmakers" who bring in business and others who handle the day-to-day work and litigation.

"Because the sourcing, pitching, and winning of new business are relatively high value-added activities, it makes sense for brokerage firms to concentrate the high-cost broker on those activities as much as possible," the study reports, while suggesting that technology and lower-cost professionals manage the workload.

Change #2: The Emergence of New Types of Brokerage Firms

Information technologies will also likely lead to the emergence of a successful discount brokerage model to handle relatively low-margin transactions catering to tenants seeking smaller, more generic spaces, the study found.

"While commercial real estate space is not nearly as homogeneous a commodity as (say) shares of Microsoft stock, we believe the Internet and associated information technologies will speed the development of a successful discount model in the commercial brokerage sector. This model almost certainly will utilize the Web

extensively, but it will not be a 'virtual' brokerage operation, in our opinion."

The study's authors acknowledge that any changes to the dominant commission-based, independent contractor structure in place today will require a fairly major shake-up in terms of how brokerage firms are staffed and how they use technology.

"While it is not yet clear precisely how such a firm will be organized, the factors necessary for success are becoming more apparent, and we believe the obstacles to success are not insurmountable," according to the study. Such discount brokerage firms "represent a major change in the underlying business model of a brokerage firm and require the meshing of new technology and firm labor force arrangements."

Characteristically, such changes are well underway in the residential side where such firms as eRealty.com and Coldwell Banker's experimental Blue Edge (www.blueedge.com) are leading the charge.

While not all firms will want to pursue a discount strategy or even offer it as part of a package for clients, the study makes clear such a model, if successful, would pose a threat to traditionally structured firms. "(A) successful discount model should be closely scrutinized by all in the industry because it always has the potential to be adapted to serve higher margin clients."

However, such a threat is far from imminent, the study concludes, because the slow adoption rate of new technology among most U.S. businesses and the lack of information standardization impair the ability of a discount model to provide services and make money.

Change #3: Development of Specialized Firms Within the Industry

Finally the study reports that the already well-established trend to outsource labor-intensive tasks related to gathering and maintaining information will continue as brokerage firms shed costs and target higher-margin consulting and service providing businesses.

Firms have formed that specialize in collecting, storing, and publishing the vast amount of information required to support real estate investment, development and transactions as new technology makes it possible to collect information more efficiently and disseminate it more widely, the study found.

"The potential cost savings from such an operation obviously arise from eliminating the duplicative effort (and associated labor costs) of having many different brokerage firms collecting virtually the same information in-house," the study found.

A single, large brokerage company operating in a metropolitan area could reap gross savings "in excess of \$150,000 annually" by using a specialized firm, the study asserts.

But while the study's authors firmly believe that technology makes conditions ripe for the development of specialist research firms, brokers will continue to need their own in-house "smaller research teams that augment and manipulate the data provided by the specialist firm."

Happy Ending

What's the bottom line?

"Brokers remain essential to the process," the study asserts. Far from being dinosaurs, brokers continue to provide a valuable and necessary service in making real estate markets more efficient.

"The fact that commercial real estate is heterogeneous really is what makes the broker relevant," conclude the authors of the study.

"The value-added a good broker brings to a deal includes, among other things, the ability to understand the market beyond the published statistics, the ability to deeply understand a client's position relative to the competition (in the case of a project leasing broker), and the ability to know when to be (and when not to be) aggressive during a negotiation... This value-added is greatest when the deal is large and complex, and technology cannot easily replicate these features because they are human in nature."

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