

Major Changes Coming for Commercial Real Estate Brokerage, As Information Technologies Make Their Mark



The Third and Final Phase of a Study by SIOR Educational Foundation Says Information Technologies Will Be Instrumental in Changing the Way Commercial Brokers Do Business, But Cannot Substitute for the High Value Brokers Bring to Transactions

DALLAS, TX -- (June 20, 2001) -- The commercial real estate brokerage industry must anticipate three likely broad changes in the way it does business, due to the rise of information technologies, according to a new academic study announced here last week during [Realcomm 2001](#), the largest conference devoted exclusively to technology, business solutions, the Internet and e-commerce for the commercial real estate industry.

Sponsored by the [SIOR](#) Educational Foundation of the Society of Industrial and Office Realtors(R), the study analyzes the current and expected future impact of information technologies on the sector, plus the way information technologies will likely affect the fundamental business model of commercial brokerage.

The study is called "The Impact of New Information Technologies on the Commercial Brokerage Industry; Phase III: What Does New Information Technology Make Possible and Under What Conditions Will Changes Occur?" It predicts three sweeping changes in the industry:

- 1.** Information technologies will continue to spur the development of research, listing and other firms that perform only a part of the brokerage process. The chief question is not whether brokerage firms will outsource their research and listing functions -- they will, because information technologies have made outsourcing data-intensive functions cheaper and easier. Instead, the fundamental issue pivots on who will provide and control the data.
- 2.** Staffing changes will include an emphasis on organizational management and team-building skills. In addition, by lowering the infrastructure costs related to research and marketing, information technologies will allow smaller, boutique brokerage operations to better compete with the larger firms in the industry.

3. Information technologies should materially influence the existing operations of traditional brokerages. Most prominently, "the basic way in which brokerage services are priced will change," according to the study. Project-based fixed prices will become more common, as well as a fee per hour worked arrangement, similar to the billing of other service professionals like lawyers and consultants. Commission compensation dominates the industry today.

4. Information technologies will likely lead to the creation of a successful discount brokerage model that focuses on smaller and more generic spaces and properties in relatively low-margin transactions.

The third finding "represents a major change in the underlying business model of a brokerage firm and requires the meshing of new technology and firm labor force arrangements," says the study. "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." The study includes an analysis of how a commercial discount brokerage might function financially.

The study also predicts that, at least in the near to medium term, these changes are more likely to affect the tenant rep and project leasing sectors of the industry, in comparison to the investment sales and corporate disposition areas. For this reason, the tenant rep and project leasing sectors should expect lower relative commission growth.

These findings come from the third and final phase of the SIOREF's landmark new study on commercial real estate brokerage, information technology and the future. Professors Joseph Gyourko and Asuka Nakahara, director and associate director, respectively, of the Zell/Lurie Real Estate Center at The Wharton School of the University of Pennsylvania conducted the three-phase study. Mr. Nakahara was previously chief financial officer of the Trammell Crow Company.

"This third and final phase of the SIOREF study provides insights into how commercial real estate brokerage professionals can use new information technologies to transform the way we serve our clients, from pricing to personnel," says Stephen Podolsky, president of the SIOR Educational Foundation and principal of Podolsky Northstar Realty Partners, Riverwoods, Ill. "It confirms that technology is not the enemy of the broker. It shows how brokers who are familiar with technology and also have good management and team-building skills will become more valuable over time. Likewise, it reports that the most successful brokers will be those who are the most

comfortable with the new technology and who can make their clients comfortable with it as well."

Change #1: Development of Specialized Firms Within the Industry
Because of the Web, the commercial real estate industry is already feeling the effects of the first change the study predicts. "The cost of collecting, storing, and publishing the vast amount of information required on any given market simply has fallen with the advent of new technology," the study says. Numerous firms have formed that specialize in listing and research. (Details provided in phase two of the SIOREF study.)

"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," according to the study. It predicts that 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.

But while the study's authors "firmly believe that the conditions for the development of specialist research firms have never been better," brokerage firms will continue to need their own in-house "smaller research teams that augment and manipulate the data provided by the specialist firm."

Change #2: General Effects on Existing Operations of All Brokerage Firms
The second change the study predicts is largely the result of technology making the real estate marketing process more "transparent" to clients. That may not only affect how a broker is compensated, but also lead to different kinds of personnel needs in a firm. "(W)e think it is possible that the basic way in which brokerage services are priced will change," the study says.

Rather than a system that pays brokers a percentage of the value of a contract signed, "a more transparent model is to price by the hour worked, just as other service professionals (e.g., lawyers, accountants, and consultants) do." Real estate economists have said a commission structure is preferable when a client can't easily monitor how intensely a broker is marketing a property. But if at least some of the marketing process is visible via electronic media, clients are likely to want to (at least partially) pay a set fee for a specific service, the study says.

And because of new technologies, brokerage firms may want to consider restructuring or reallocating personnel. "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 says, suggesting that technology and lower-cost professionals step in for other tasks.

Change #3: The Possibility of New Types of Brokerage Firms

"Among the greatest impacts (of new information technologies) will be on the very model of doing business," says the study. While many have been focusing on a 'virtual' brokerage, the authors point to the potential of a distinct discount model, similar to what we've already seen happen in stock brokerage.

"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," the study says.

"This model almost certainly will utilize the Web extensively, but it will not be a 'virtual' brokerage operation, in our opinion."

The study adds, "Not all firms will want to pursue an explicit discount strategy or even offer it as part of a package for clients. However, 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."

According to the study, the key factors making an electronic or virtual brokerage very unlikely to be successful, certainly in the near to intermediate term, are the lack of technology adoption and information standardization.

"The fact that commercial real estate is heterogeneous really is what makes the broker relevant," say 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."

These findings come against the backdrop of the first two phases of the SIOREF study.

Phase one estimated the size of the office and industrial brokerage sector and its profitability; it provided authoritative figures for benchmarking the future impact of technology and showed that the brokerage industry's sizable revenues are great enough to continue to attract e-commerce innovations and entrepreneurs to commercial real estate.

- ◆ The second phase documented and analyzed existing e-commerce initiatives in the commercial brokerage area; it showed that despite a mixed record of successes and failures among new firms that use the Internet for listing, selling and leasing commercial real estate, the Web will nonetheless emerge as "an important distribution channel and conduit of information for commercial real estate brokerages."

Copies of all three phases of the SIOREF study, "The Impact of New Information Technologies on the Commercial Brokerage Industry," can be purchased by calling Diana Lee at the Society in Washington, DC at 202-737-1150.

The Society of Industrial and Office Realtors, based in Washington, D.C., is an international association of commercial real estate professionals. The Society's 2,700 members in the U.S. and other countries include 2,000 commercial real estate professionals who have earned the coveted SIOR designation, which stands for Specialist, Industrial and Office Real Estate.

Last year, SIOR designees closed more than 68,000 buying, selling or leasing transactions involving 2.4 billion square feet of commercial real estate. These transactions totaled \$51.7 billion, or an average of \$25.7 million per member.

The SIOR Educational Foundation is a not-for-profit 501(c)3 organization whose mission is to promote, sponsor and support education and research initiatives that advance professionalism in the commercial real estate industry.