

# Real Estate Strategies

## Ignoring the Elephant in the Room?

# Brokers Who Serve Two Masters

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DUAL REPRESENTATION BROKERAGE IS THE REAL ESTATE BROKERAGE INDUSTRY'S "ELEPHANT IN THE ROOM".

Dual agency occurs when one real estate company represents both the tenant and the landlord in a lease transaction. Sometimes it is one individual on both sides; other times it is two individuals within the same firm.

No one serves two masters.

Every year tens of thousands of businesses are misled by brokers whose true loyalty is to the landlord. This costly mistake translates to higher rent, more overhead and less profits. Yet, like an elephant in the room, many business tenants negotiating a lease ignore the elephant and allow a major component of their future impacted by people whose loyalties lie across the negotiating table – the dual rep broker and his true client, the landlord.

In Southern California, a professional services firm that occupied 15,000 square feet of office space was approached by its building's listing broker and his landlord. This dual-loyalty broker and his landlord client said all the right things to the tenant, focusing on the great relationship they had shared over the past ten years. They told the firm not to hire an outside broker to represent the tenant's interests and offered the tenant "a below market deal." The dual-agency broker promised the tenant that it would save the cost of a commission, and that savings would be reflected in reduced rent.

The tenant was contacted by our ITRA office, and happened to ask if we could review the landlord's "wonderful terms", based on our recent experience in the building and in the surrounding area.



What happened next shocked the tenant: we showed them that the deal was below the belt, not below the market. The proposed rent was actually \$4 per foot higher per year than recent new deals we had finalized in the same building. In addition, the landlord wasn't going to change the tenant's base year for operating expenses. In the proposed deal, they would pay an extra \$.40 per square foot per month in expenses, and that increase would have continued for another ten years had we not reviewed the deal. The tenant was offended by the deception attempted by the landlord and the landlord's broker. We moved them out of the building to higher quality space in a better building and saved them almost \$2 million dollars.

Although the commercial real estate market has been trying to hold the lid on this dirty little secret for decades – it's called *conflict of interests* – a growing group of tenants is having an epiphany. These savvy tenants are realizing that in the world of big commercial brokerage houses, the house wins, and in this case the house is always the landlord, because that is where the money is!

The landlord's goals and objectives clearly conflict with the tenant's. Next to payroll, "rent" is the highest expenses for most companies. Rent is defined as base rent plus all the additional occupancy costs landlords impose upon tenants during their lease term, including operating expense pass-throughs, real estate taxes, parking charges, amortized tenant improvements, and much more.

Landlords are in the business of leasing and operating office buildings: they are pros at it. They know every trick in the book. And their soldiers are the landlord brokers.

How does a broker who has a listing on a building, and a fiduciary responsibility and contractual obligation to the landlord, fairly and adequately also represent the tenant? The answer is, no matter how much marketing spin they might use to justify it, they can't.

An unsuspecting tenant doesn't stand a chance when standing alone against a dual agency broker and his landlord. Commercial tenants aren't in the real estate business. Their focus and experience lies in whatever it is they do to maximize their own profits and maximize expenses. However, one sure way to minimize expenses is to hire a specialized tenant representation firm and level the playing field when negotiating an expansion, renewal, relocation, contraction or purchase. An exclusive tenant rep firm – like ITRA – only represents space users, never landlords.

Let's look at another example: A tenant was renegotiating his firm's lease directly with the landlord and the landlord's broker. Without a tenant representative in his corner, the tenant was at a disadvantage. ITRA stepped in and reviewed all the correspondence as well as the existing lease. The landlord was threatening to re-measure the space per BOMA 1996 standards. This would have increased the tenant's core factor by more than 7%. However, we pointed out that the tenant had a favorable extension option which they hadn't exercised yet, and the lease was specific: the landlord had no right to re-measure the space. We helped the tenant go to arbitration, and saved them \$1,000,000 in rent – money that would not have been saved had they used a dual representation broker.

Dual representation brokers serve landlords in securing additional listings or management contracts, from the landlords, or to market their success to other potential landlords.

When this writer started in this business over 23 years ago, everyone worked for landlords. We made our money by filling landlords' building with new tenants and retaining tenants on lease renewals. It wasn't until the mid 1980s that exclusive tenant representation started to emerge as a realistic business model accepted by corporate users.

A tenant broker wants to do a good job, develop a long-term relationship with the client based on trust, and win referrals to other tenants in their market in the process.

The choice is yours! Let's send the elephant packing!

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