Sperry Van Ness
Commercial Real Estate Advisors®

COMPENSATED COOPERATION

You didn't get into the commercial real estate business to lose money. But did you know that the existing business model for commercial real estate may be costing you thousands of dollars in potential commission? Or that it takes the focus away from providing the best possible result for clients–the kind of results that yield referral and repeat business? It happens every day and the brokerage community has accepted it as the way business is done. It doesn't have to be this way.

Real estate expert and blogger James Kimmons recently asked, "Is the commission split model for the real estate brokerage business in danger of extinction? With virtually every other facet of our business changing, from marketing to delivery of services, can we really reasonably expect to maintain the status quo for compensation structures?"[1]

The Sperry Van Ness International Corporation (SVNIC) doesn't believe so. Founded in 1987 on the Compensated Cooperation concept, the Sperry Van Ness® organization has been leading the charge toward change ever since. We are determined to shift the way commercial real estate business is done while also improving commissions across the board.

THE WAY IT IS:

As a businessperson, you understand how demand works. It's Economics 101. When demand goes up, prices go up. The larger the market, the greater the demand. So why would anyone want to actually decrease demand? "The reality is that the market is one of the most segmented, fragmented,

[1] *Kimmons, J. (2014). Real estate agent commissions & brokerage business models. Retrieved from http://realestate.about.com/od/staffingandoperations/a/agent_commissio.htm*

and dysfunctional markets in existence," explains Sperry Van Ness President and CEO Kevin Maggiacomo. "It operates in an environment where the listing broker controls the flow of information to potential buyers, often causing the property to sell for less than market value." It's true. In more than 80% of commercial real estate deals, listing brokers share their listings with just a portion of the brokers across the country. Often, understandably, this is driven by a profit motive. "The more that a broker quietly markets an investment sales listing in an effort to identify a buyer on his or her own, the greater the chance that he or she will earn 6% instead of 3%," says Maggiacomo. Which sounds fine, until you realize what's really happening: by limiting the property's exposure, the broker willingly reduces potential demand for the property.

"Do Real Estate Brokers Add Value When Listing Services Are Unbundled?" asks a 2008 paper produced by the National Bureau of Economic Research.[2] In this study, economists B. Douglas Bernheim of Stanford University and Jonathan Meer of Texas A&M University looked at the housing market in the vicinity of Stanford to measure the effect brokers had on pricing. They note: "On one hand, brokers offer potentially useful knowledge and expertise. On the other hand, because the relationship between the homeowner and the broker resembles a classical principal agent problem, the broker may not deploy services in ways that promote the seller's interests." In their findings, listings that went through a broker reduced the selling price of the studied properties by 5.9 to 7.5 percent. In the paper, the authors cite a study by Steven D. Levitt and Chad Syverson, which emphasizes that an agent "has strong incentives to sell the house quickly, even at a substantially lower price." [3]

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In a *Washington Post* article from May 2013, real estate writer Kenneth R. Harney notes, "By restricting access to information...to relatively small

[2] Bernheim, B. D., & Meer, J. (2008, February). Do real estate brokers add value when listing services are unbundled? Retrieved from http://www.nber.org/papers/w13796

[3] Levitt, S., & Syverson, C. (2008). Market distortions when agents are better informed: The value of information in real estate transactions. Review of Economics and Statistics, 90(4), 599-611.

numbers of potential buyers, agents are not fulfilling their core duties to their seller clients and not obtaining the highest possible prices." [4] While these examples are from the residential real estate markets, commercial real estate brokerage is structured similarly with similar results.

Which begs the question: Why would they do that? The answer, of course, comes down to money, and who's making what on the deal. In the book *Freakonomics: A Rogue Economist Explores the Hidden Side of Everything*, Steven D. Levitt says, "As incentives go, commissions are tricky. First of all, a six percent real-estate commission is typically split between the seller's agent and the buyer's. Each agent then kicks back roughly half of her take to the agency. Which means that only 1.5 percent of the purchase price goes directly into your agent's pocket." [5] That low percentage also affects the incentive to incrementally increase a property's price. Consider the difference between selling a property for $3 million and selling it for $3.2 million. While the seller would see a gain of $192,000 on the deal, the broker is looking at just an $8,000 gain–and only $4,000 if he or she has to split it. So where is the impetus to continue to push for the higher price?

These numbers also suggest why brokers would refuse to share commission, even though doing so reduces incentive for the buyer-side broker to show listings to their clients. That, in turn, reduces the number of offers. From there, the math is simple, and it equals an unfortunate trend: When demand goes down, prices go down. When prices go down, commissions go down. Most of the studies have only been done on residential sales revenue, but as noted, the same situation exists in commercial real estate.

Unlike residential sales, most commercial real estate sales aren't local, which means buyers often come from across state lines, and it's more likely brokers who aren't actively publicizing properties are not creating the demand that will yield the best value for clients.[6] Furthermore, this lack of sharing commissions occurs not only at the public level, but internally within commercial real estate firms and are often cited as a major reason why excellent commercial real estate professionals look for work elsewhere. Mike Myatt, a top leadership

[4] *Harney, K. R. [2013, May 09]. 'pocket listings' allow realty agents to make sales without sharing commissions. Retrieved from http://www.washingtonpost.com/realestate/pocket-listings-allow-realty-agents-to-make-sales-without-sharing commissions/2013/05/09/6c0b9a7e-b675-11e2-92f3-f291801936b8_story.html*

[5] *Levitt, S. D., & Dubner, S. J. [2005]. Freakonomics: A rogue economist explores the hidden side of everything. New York: William Morrow.*

[6] *Myatt, M. [2008, June 06]. Management matters with mike myatt: How to reduce employee turnover. Retrieved from http://www.cpexecutive.com/homepage/management-matters-with-mike-myatt-how-to-reduce-employee-turnover/*

advisor to Fortune 500 companies and author of the books *Hacking Leadership* and *Leadership Matters*...the CEO Survival Manual, notes that "companies with poor leadership often trip over dollars to pick up pennies when it comes to compensation. People will often cite non-competitive compensation as an issue for leaving a company, but what they are really stating is that the company has an unsophisticated leadership team, which is out of touch with both the market, and the needs of its employees."[7] Kevin Maggiacomo, Sperry Van Ness President and CEO adds, "No one broker and one brokerage firm can possibly identify all potential buyers for a property. It takes an entire brokerage community to do that." According to Real Capital Analytics, a renowned commercial real estate online tool that offers a comprehensive look at global commercial property investments, two out of three investment deals are done across state lines. That's 66%!

HOW IT CAN BE

This is where the SVN Difference comes in. We think it's time to change how things are done because it's the right thing to do for everyone. Sperry Van Ness Commercial Real Estate Advisors™ embrace new ideas like crowdsourcing and democratization of information. SVN is recreating and leveling the playing field for commercial real estate. One important way we do that is through Compensated Cooperation. As a Sperry Van Ness® Advisor, you receive the advantage of being part of a team that looks at the entire 100,000-strong brokerage community as its distribution channel. A team that proactively shares fees 50/50–every time.* A team that brings to the market a unique focus on the seller's interest, because maximizing the client's value is good for everyone in the long run. Plus, you'll have plenty of tools at your disposal: real-time syndication to major listing sites, social media and email campaigns, the SVN Connect app, and our open weekly National Sales Call. It's all designed to create transparency in the marketplace and a more efficient sales ecosystem.

"At SVN we believe achieving the highest and best price is our client's right. That's why we practice Compensated Cooperation where we proactively share fees with outside brokerages," explains Maggiacomo.

[7] In 2013 65% of transactions over $2.5 million were done across state lines. Data from Real Capital Analytics.

**Qualifying transactions*

Sperry Van Ness
Commercial Real Estate Advisors®

READY TO GO FORWARD?

Then we're ready to talk to you about your Sperry Van Ness® franchise.

GEORGE SLUSSER
CHIEF GROWTH OFFICER
george.slusser@svn.com
(706) 455-4933