THREATS TO CRE

By Steve Bergsman | Sponsored by SIOR Foundation

SIOR members are innovative by nature; ethical, hard-working, and experts in their market. And many that the *SIOR Report* talked to seemed to agree on one thing: the major threat to CRE right now is disruption—often disruptor companies or forms of technology that cause radical changes through innovation.

Sometimes these disruptors—realized through the establishment of a corporate entity—can suffer from self-inflicted financial wounds due to poor management or planning. Such is the case with companies like Uber or—in the commercial real estate world—WeWork. Although WeWork teeters, the original vision of the company was so innovative, and more importantly, applicable, that the market has been irrevocably changed.

Currently, the commercial real estate world is dealing with two serious disruptors. The on-going changes wrought by WeWork, and the transformations that are coming due to a vigorous application of technology to the industry.

Let's first turn to the FutureWorld.

“It's a bit farfetched to think that robots and artificial intelligence can automate what we do as brokers in commercial real estate,” observes Rob Renaud, SIOR, executive vice president and principal of Global Client Services at Devencore, Toronto. Yet, Renaud is already looking over his shoulder at companies such as

Truss. Based in Chicago, Truss offers an online marketplace for small- and medium-sized businesses to locate, tour, and lease space.

The concept has limitations except for smaller transactions, says Renaud, although he admits it works for the millennial generation, most of whom are tech savvy and want to interface online through a portal rather than talk to someone directly.

"The bigger real estate projects that require a delicate touch and strategy, where tens of millions are at stake and with cultural impact, that business won't be displaced," says Renaud. "But other brokers will be disrupted."

For spaces that are easy to lease and not complicated to negotiate, online marketplaces will ultimately be a threat to that strata of business, says Renaud. "If I was a broker working the lower end of the market, wading through small-to medium-sized deals, I would be worried about my ability to keep that business."

Although Truss' numbers aren't equitable to unicorns like Uber, WeWork, Airbnb, or Ant Financial, it "has gotten lots of funding," says Renaud. "It is very entrepreneurial and growing."

That's just one new company. An overarching issue in the commercial real estate world is that the large, traditional companies are investing heavily in technology, and that could eventually result in a concentration of business into fewer corporate hands than in the past.

"What I have seen over the last five years is that bigger companies—the CBREs, Cushmans, and JLLs—are all investing a ton of money in proprietary technology. These firms have been acquiring start-ups that provide software programs for analysis or transaction, which on a wider scale is great as it pushes the technology forward," says Bo Hargrove, SIOR, a principal in Raleigh, N.C.

For Hargrove's company, the independent Rich Commercial Realty—and many like it across the country, if not the world—it doesn't have the capital to just go out and acquire a software company. "The unfortunate side of technology, especially when dealing with existing firms that dominate a sector, is that to access proprietary data or software is really expensive," he adds. "That will be an increasingly more difficult issue if the market consolidates in the future."

As a firm, Rich Commercial Realty annually spends more money on technology than it does for its Class A office space in Raleigh. "For the vast majority of our clients, real estate is now the second largest line item," says Hargrove. "For us, the cost and barriers to entry in regard to the technology that we need to operate has become a major expense. I do not expect that trend to change in the near- to medium-term."

This is not just a U.S. problem. Ernesto Gamboa, SIOR, head of Corporate Transactions for Remarks in Quito, Ecuador, declares, "The main threat that is happening in commercial real estate is technology."

Gamboa is not against technology, but he realizes what it means for the industry. "The few, big players will get more and more business," he says. "Technology is good for market leaders. It is a way for those companies to dominate. For the small brokers, technology is going to be useful, but it will not be enough to compete against the tech-savvy giants."

For companies such as Remarks—which has to win business from the global giants that need to come to cities such as Quito—it, too, has to be tech savvy and innovative, which is why it is investing in product development. This year alone, Remarks has created its own software to help automate processes.

"You have to be creative in order to give clients the solutions they need," he says. "The global organizations require more information, more detail and strategies for specific transactions. In places such as Quito where these firms don't have operations, companies like Remarks are called upon to organize all the local data. If you are dealing with big, international companies, you have to automate the brokerage business."

The automation of small commercial real estate leases without using a broker is not much different from the co-work concept that WeWork offers. As a start-up or a small, entrepreneurial firm with maybe five people, it was easier to just go to the nearest co-work development and sign a lease than hire a broker to find the diminutive amount of space that might be needed.

In Raleigh—which is located in North Carolina's technology triangle between Duke University, North Carolina State, and University of North Carolina—it's a landlord's market. As Hargove points out, if you want a nice office space, you are going to have to build it out and the cost of construction is extremely high. The result is local landlords who do not want to offer a short-term lease for anything less than five years. For a start-up that could be a challenge, which is why he calls WeWork a "fantastic option for those clients."

Three WeWork developments have been built-out in the Raleigh area and "all are well-occupied," says Hargrove.

Up in Canada, some of the country's biggest pension funds have invested in WeWork and still believe in the concept. Although many of the WeWork centers are at capacity, Renaud has seen where

"When you have a company that needs to keep expanding in order to one day be profitable, it is unlikely to ever be profitable unless someone comes in and buys it out."

WeWork space has been put back on the market. "For those very small deals, this is where co-working is useful," he says. "And is where the broker business has been disrupted."

Less optimistic is Jack Britvan, SIOR, president of Commercial Real Estate Services of Long Island in Jericho, N.Y., who takes a very practical view. "I anticipate a substantial amount of the existing WeWork space will be dumped back into the market within the first six months of 2020," he says.

Britvan's question with WeWork is not about its format or how co-working has transformed commercial real estate; it's about what will happen to property markets in the suburbs of New York City, including New Jersey and Westchester County, if WeWork dumps space in the city through a Chapter 11 filing or via sublease.

"For brokers like me in the suburbs, a company that could have expanded on Long Island might now expand back into New York City if existing market rents are substantially reduced and made available," he says. "If city rents are quickly reduced, tech and non-tech firms will likely open offices in Manhattan or expand elsewhere within the city."

Britvan's conclusion about WeWork: "When you have a company that needs to keep expanding in order to one day be profitable, it is unlikely to ever be profitable unless someone comes in and buys it out. I never understood how WeWork, with its aggressive plans for growth, was going to make it."

WeWork is New York City's largest tenant with more than 7 million square feet. Today, flexible-workspace firms occupy about 17.6 million square feet in the Big Apple. A similar fast-growing competitor to WeWork is Knotel, which will have over 500,000 square feet in the city within six months.

In the short-term WeWork's missteps could mean more office space coming to local markets, but in the long-term, commercial real estate has already been transformed by WeWork's vision of co-working, and that might not be so great for small brokers.

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