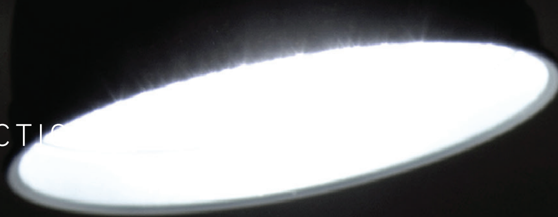

WHAT'S KEEPING BROKERS UP AT NIGHT?

By Steve Lewis | Sponsored by SIOR Foundation

When seeking to discover what has SIORs most concerned, one thing becomes clear: whatever answer you come up with, you can guarantee it's not universally shared. First of all, markets vary widely, and with that variation comes different challenges that are top of mind based on where you're looking. Add to that the fact that different SIORs will often see the same market factors, and their inherent risk, in different ways.

For example, notes Street Jones, SIOR, principal, vice president RCR | Rich Commercial Realty in Raleigh, N.C., "What I hear most of our colleagues say, which is the easy way out, is the economy scares people—that there's some kind of looming recession," he shares.

However, he continues, "as an independent small brokerage firm, we're not worried about that because our overhead is low. These medium to big firms have a ton of salaried people—property management teams, project management teams, and salaried positions besides brokerage—so they get hit really hard during a recession. With us not having that, it makes me more comfortable. Also, we're in a thriving market, and a downturn still creates real estate transactions—subleases, dispositions—so there's still business to be had."

So, does anything keep him up at night? "For me, the first thing that really keeps me up is that we have been to the finish line on so many deals and gotten the rug pulled out at the last minute by big tenants—they eat our lunch," says Jones. This has happened more this year, he says, than in all his other working years combined. "It's left me with a little egg on my face, but there's nothing you can do if some national credit tenant comes out of the blue," notes Jones. "It keeps me up that we have little or no control; if someone comes in at the last minute from out of left field and you just don't have any leverage."

His second big challenge, ironically, is a result of the strong economy. "There are a lot of mergers and acquisitions (M&As) going on, more than in the past," he notes. "Companies that we've had great relationships with—multiple transactions—have all of a sudden gotten acquired by a larger beast that has relationships elsewhere, and the decision-maker we've worked with for years and years is a middle-man on the totem pole."

In a related development, he continues, he's seen some clients that have acquired a lot of business for him "suddenly get the boot"—particularly in the tech sector—and the opportunity to work with those companies is gone after years of strong relationships. "We've had three tech companies in the past six months acquired by monster outlets having agreements with CBRE

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and Cushman, and we're hung out to dry," he says. "In some cases, we've even done half or three-quarters of the work, and then we hear, 'By the way, you're not involved anymore.'"

Justin Cazana, SIOR, principal | broker with Avison Young in Knoxville, Tenn., looks at potential problems from the point of view of being a broker, but also from that of being a principal and founder. "From being a broker, you get this feeling, the way things are moving and all the activity—here we are [right now] and every minute is accounted for," he shares. "I'm not complaining, but this is what it felt like in 2008 before it all fell apart." He takes comfort in the fact that residential brokers are "scared," but the fear is still in the back of his mind. "I'm always trying to read the tea leaves," he says, "And that's one of the scary things ."

As a principal, he is concerned about construction costs, which continue to "skyrocket" and put a crimp in the markets of Knoxville and a lot of tertiary cities. "I can put someone in a three-year-old Class-A building for $21-$22 a foot, full service," Cazana notes. "If I built one now, it would probably be $26-$27—and that's just over four years. If you're a CEO of tenant A, how do you go to the board and say, 'I'm about to increase our real estate costs 30%' just because you want go into a new building?"

The bottom line, he says, is that Knoxville is developing a shortage of Class-A office space in its "hot" areas. "We have a 45-year-old building with a wonderful location, 180,000 square feet and 94% leased," he says. "Just 200 yards away there's a building that's only eight years old and it's 95%-96% leased. That's great for landlords, but in fact there's no new sizable product coming on the market. In the long run that hinders economic development; if a Fortune 500 company wants to come to Knoxville and wants 45,000 square feet, they can't get it unless they're willing to wait. That hurts everyone down the road."

And in Cincinnati, shortage of space is also a concern, but on the industrial side. "The lack of mid-sized freestanding buildings is the number one issue that brokers seem to face in our market," says Norm Khoury, SIOR, brokerage senior vice president | Cincinnati Industrial Services Group, Colliers International. "Developers are building lots of e-commerce spec buildings from over 300,000 square feet to one million square feet. Nine buildings in this range were completed in 2019 while four more are slated to complete in the first half of 2020. This compares to only five completions in this size range between the start of 2015 and the end of 2018. Meanwhile, there is a lack of free-standing industrial buildings as developers elect to invest in these larger, more lucrative projects."

The construction of larger e-commerce distribution centers, he explains, creates a large pull on the existing labor market. Absence of available, competitive labor, he predicts, will push occupiers to seek alternative locations that are separate from the large distribution centers, where e-commerce giants like Amazon can offer more lucrative wages.

"These options are few and far between in the Greater Cincinnati market, due primarily to strong occupancy and very little speculative development in that category," says Khoury. "High construction costs are keeping developers from completing smaller speculative industrial projects. In addition, timing is 18 months from design to site selection to completion. This leads to a loss of deals in the market and causes tenants/ users to look outside our market." What's more, he adds, this has been a growing trend for the past five years.

BUT WILL CONCERNS LAST?

Speaking of the past five years, what about the next five years? Are these challenges things that will always keep brokers up at night, or are they shorter-term trends? "I hope they're short-term trends," says Cazana. "They were not a concern three years ago; I knew construction prices had started to creep up, but now it's past 'creep.'"

What does keep him up at night about the future is the fact that he has junior brokers who have only been in the industry for five years or so "who have seen nothing but great times in real estate. A big concern is when it turns, in six months or six years, there will be a major shift on how to attract them."

His other concern, he continues, is that the art of cold calling has gone by the wayside, "because today you can sit by the phone and let it ring." How does he address that? "Being a thought leader and an influencer is the key," says Cazana. "Pass it along that a lot of us in the office have seen ugly times. They absolutely have to make time to make cold calls." His office, he says, has accountability meetings and asks brokers how many calls they have made in the week, how many buildings they have walked through, and how many tours they have led. "If you're supposed to make 20 calls and you haven't, you put $10 or $20 in the 'pain jar,'" he shares.

"For me, here in our market, I see both being a little bit longer term," says Jones. "Part of the reason is product availability. Our vacancy rates are low, and until we get lots of new product coming online, well, there will still be serious competition for these spaces."

M&A, he continues, is directly tied to the economy, and that will slow down, "But our market is a hot market, so that would depend on the severity of a potential recession. We've gotten so much larger in the last ten years, and hopefully much more stable."

Overall, says Jones, he's not too concerned yet about anything in the future—although there is something looming. "As a small firm, we've seen a ton of consolidations this year," he says. "JLL had a very small presence, but now they've made an acquisition and there's a big push for their team. CBRE is here now, Cushman's here, and they're gobbling up small firms. For me as an independent firm it's not necessarily a bad thing in terms of winning business, but it's a challenging piece that they're investing so much in technology and systems, and it's hard as a small firm to compete. They develop amazing products in house for brokers and clients, generating data and analytics, which makes them look a little savvier."

For Khoury, he sees "trade issues and national government infighting" as possible clouds on the horizon. (For more on the potential effects of trade issues, see our article on 2020 election impacts on pg. 46.)

Cazana believes the best strategy for mitigating some of these concerns is simply being educated enough to calm the concerns of clients. "So, for example, when someone says they do not know what's happening with the economy, you can give a real educated discussion about what you've heard, and who you've talked to," he says. "Many people are concerned, for example, about the inverted yield curve, but you can point out to them that recessions usually don't occur until at least 18 months after they're seen. That keeps clients from thinking that in three weeks the world will fall apart." With education, he concludes, "you can speak wisely to clients" about some key economic issues. ∇

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