The Art of the Deal: Value-Added of Advisors in Commercial Real Estate Transactions

Discussant: Lingxiao Li

California State University, Fullerton

This Study

- Question to ask:
  - How does brokers add value in the commercial real estate industry?
- What the authors do?
  - use a building fixed effects model to predict the impact of brokers on prices of commercial real estate transactions.
  - use a hazard model to assess the relationship between brokers and time on the market (TOM).
- Findings:
  - Transaction advisors provide clients with a faster transaction process, not better deal pricing.
  - Out of state investors buy at a 4.4 percent premium and sell at a 4.8 percent discount.
  - Transaction advisors could mitigate the adverse effects of investor distance when advising buyers.

Comments

- Important Question:
  - According to the Federal Reserve's Financial Accounts of the U.S. (2019q1), the gross real estate holdings of nonfinancial corporations were $14.6 Trillion and the nonresidential real estate assets of nonfinancial, noncorporate businesses totaled $5.4 Trillion.
  - In 2018, transaction volume in the U.S. commercial real estate market amounted to more than USD 562 billion.
  - Commission rates for commercial real estate brokerage average 2.5 to 4 percent.
- Contribution:
  - Study on commercial real estate transactions helps to assess transaction advisors' added value in deal-making directly.
  - Shed light on the performance and value-added of commercial real estate transaction advisors.

Comments

- Well written paper:
  - Distinguish different kinds of brokerage involvement in the transaction.
  - Use a building fixed effects model to address the potential selection bias of transaction advisors based on asset quality.
  - Investigate the effects of broker presence on both price and TOM.
  - Study how commercial real estate brokers mitigate the adverse pricing effects for non-local investors.

Comments

- Valuation Approach
  - Residential Real Estate: Sales Comparision Approach
  - Commerial Real Estate: Direct Capitalization or Discounted Cash Flow
- Does the analysis in the rich literature of residential real estate apply to commercial real estate?

Comments

- Investor type matters (discount rate):
  - Insurance Company, Pension Funds, REITs...
- Brokerage firm characteristics matter (connection): Who you know?
  - It is hard to get big property deals done unless you have a wide circle of potential buyers, sellers, and financiers.
  - Informally information sharing: newsletters, bilateral meetings,etc.
- Property type matters:
  - Stabilized deals, also known as "core real estate"
  - Renovation deal
  - REOs
- –>Include controls for investor type, brokerage firm type.

Comments

- Building fixed effect model controls for
  - selection bias (broker presence is endogenous to property quality).
  - absorb observed and unobserved property characteristics.
- It does not control for
  - micro side: changes in management, tenant quality, etc.
  - macro side: changes in cap rate, demographic shifts, or changes to the local area.
- –>Include Location*Time fixed effect to control for micro and macro factors.

Comments

- Transaction price and TOM are determined simultaneously.
  - Non local buyers pay 4.4% premium and non local seller sell for 4.8% discount.
  - Non local buyers and sellers conclude transactions faster.
- –>Robustness check on a simultaneous estimation of price and TOM with the same sample.

Comments

- Non local buyers pay 4.4% premium and non local seller sell for 4.8% discount.
  - search cost channel: higher search costs/information asymmetry problems associated with distance.
  - behavioral biases channel: anchoring based on the price levels in the investors' local market.
- –> Include controls for relative price level of investor's home market and transacted property's market.

Comments

- Broker's role may become more important under low liquidity and high price uncertainty.
- –>Include controls for liquidity and price uncertainty
  - liquidity:the number of transactions by year, property type and zip code.
  - price uncertainty: the square of the residual from a hedonic price regression estimated by property type, year, location and the standard structural characteristics.
- –> Crisis period versus non-crisis period

Comments

- Multicollinearity between broker presence and other controls in price and TOM estimation.
  - Table A1 shows that broker selection is endogenously determined.
- Control for unobserved property and transaction characteristics correlated with buyer and seller characteristics.
  - –>Harding et al. (2003), Ling et al. (2018).