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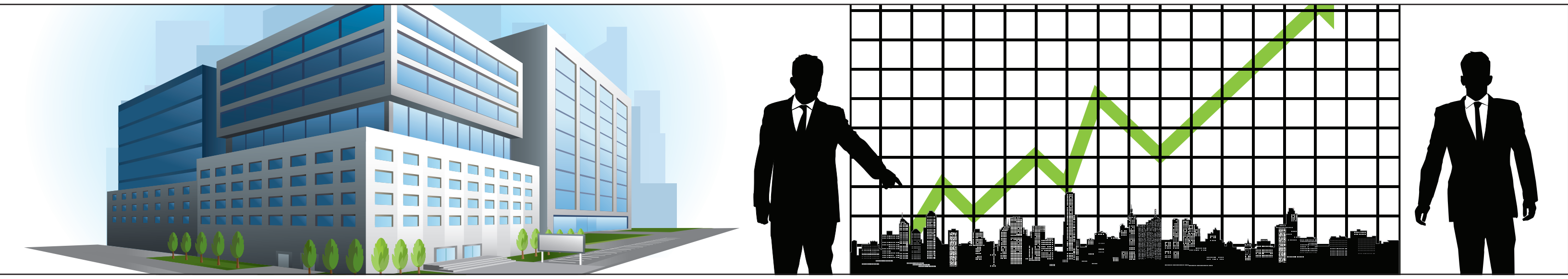
Perspectives - Steve Marcussen and Jonathan Sklar of Cushman & Wakefield

James Hagy
New York Law School, james.hagy@nyls.edu



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Steve Marcussen and **Jonathan Sklar** of Cushman & Wakefield's Los Angeles office share thoughts with **Professor James Hagy**, Director of The Rooftops Project, on how not-for-profit organizations can be more effective with their real estate assets and in implementing projects with outside real estate brokerage advisors.

Steve Marcussen is an executive director at Cushman & Wakefield. He has been involved in the commercial real estate industry for more than 30 years, having worked for Cushman Realty Corporation from 1984 to June 2001 when the firm merged into Cushman & Wakefield. He has represented some of the country's most respected institutions and developers, and is responsible for negotiating two of the largest lease transactions in Southern California history.

Jonathan Sklar joined the downtown Los Angeles office of Cushman & Wakefield in 2010. He provides tenant representation to not-for-profit organizations, as well as to businesses. Before his transition into commercial real estate, his career focus was in fund-raising for higher education, most recently with Claremont McKenna College, where he had major responsibility for the annual fund and was a member of the team that developed the strategic plan for their five-year, $800 million capital campaign.

RTP: Jonathan, you spent years working inside not-for-profits before joining Cushman as a real estate advisor. How has that background influenced your viewpoint about real estate for not-for-profit organizations?

Jonathan: What is great about real estate decisions is that they are all quantifiable. It is purely an analytical decision. The question in the nonprofit sector has been how we transition from a gut-check decision-making process to a process that is more business-driven and more quantifiable. Nonprofits want to get away from effort measurement, and to quantify where you can. Real estate is very quantifiable. You can measure efficiency in real estate.

Steve: Cost and performance.

Jonathan: This may be the only category in which you can be this analytical. This should be a no-brainer. This you can absolutely quantify.

Steve: For the smallest operators, the challenge is realizing how much space costs. Even if it is a small office space, with all the utilities, and the equipment, and all the people, it's quite expensive. Take small social service organizations—the young ones, the new ones, those without a broad base of funding support. Their number one thing is to serve their community, and they often have a terrible time finding a place to have their office. Some organizations can find not-for-profit incubator spaces and that can be very beneficial for them.

RTP: I often ask not-for-profit organizations how they view the balance between frugality and function in picking their space, even where they have sufficient funding or the choices may be cost-neutral. What are your thoughts on that?

Steve: I think space can describe what kind of organization you are. Jonathan and I worked with a small charitable organization here in Los Angeles where we were able to find subleases in the best buildings in town. But it really didn't fit their image. Even if it was cheap or free, they didn't want it.

RTP: The sublease space looked too nice?

Steve: Absolutely. You could put a sign on the front saying, "This is really cheap space. We only pay 50 cents per foot a month, even though it looks like an art museum." But the space represents the image of the organization and has to be consistent with that. So they stayed in a Class B building in a little less upscale part of town. We were able to drive down the rent to lows that they didn't anticipate and curb the parking costs.

Jonathan: The choices are more complicated than they seem. You are watching every single nickel at a nonprofit, especially those with the smallest budgets. The organization is thinking that the lease is $1.65, and we want to get it down to $1.60 per square foot. They are forgetting the total cost, or they are forgetting that they will have to stick a staff member in a closet and that staff member isn't going to be as productive. They are so focused on the nickel that they forget the bigger picture. They may not focus on other factors like work environment.

RTP: When you work with decision makers who are not in the real estate business, their involvement may only be occasional and so they may have less experience with these types of projects. What can they do to prepare themselves better to meet with you, make better use of your time, and get the process started well?

Steve: To understand their mission and what their budget is. As you know, when you look at a lease it is like a long walk down a lane. When you get to the end of the lane, the decision is pretty obvious to you. But at the beginning you never know what is going to happen during the trip.

Appoint a group of people who actually have power within the organization. This can be, for example, a subcommittee of the board that is empowered to make a decision, and that is knowledgeable about real estate and is willing to make a decision. Maybe that is the biggest thing. Otherwise when they reach the conclusion, they usually have to go all the way back to the beginning and bring the board and the organization all the way along through the process.

RTP: Some organizations think that not using real estate advisors saves money. Not because they don't believe they could get good advice, but they think somehow that the rent will be lower if they don't use somebody.

Steve: A better way to do it is to hire the best person that you can hire, ask them to give back a portion of their fees as a charitable donation, and then let the professionals do their work. If we didn't save clients money we wouldn't be around.

At our organization, we have a specialty practice for nonprofit organizations, just like we have specialized practices for other industries, like education, health care, or law firms. As a first condition, typically we agree to give a portion of the commission back to the nonprofit. This creates awareness in the nonprofit that we are doing good, that we are trying to participate with their mission, and that we are on the same team.

RTP: And who pays the commission by the way?

Steve: Typically the landlord.

RTP: And so if the organization didn't use a real estate advisor the rent is lower as a result?

Steve: No. The landlord will pay his advisor more, perhaps twice as much in some markets. For most properties, the landlord has mortgage financing as part of its capital structure. And the financing generally assumes a certain vacancy rate, say 5 percent, for the building in its pro forma budget. The brokerage fees are all underwritten in a loan document, so anytime the landlord does a lease it pays a commission to the landlord's broker. In many markets, that commission is shared with the tenant's broker. But the whole commission typically goes up to the landlord's broker who represents the building if the tenant comes in unrepresented.

RTP: Do you think that advisors who tend to work in the Class A market are as equally aware of Class B or C space as someone who only concentrates on suburban or local deals?

Steve: It depends market to market. If it is a small space, like a nonprofit outreach center where they are delivering goods to people, the local brokers may know much better. The Class A office broker from the central business district may not want to help, or may not be capable or aware of the community the same way the local brokers are.

I think you approach it the same way you buy a house. You drive around the neighborhood and see who has the most signs up. Then you call that person because he or she is going to have the most knowledge of the neighborhood. And you can call more than one. I always recommend calling everybody who has lots of signs up in the neighborhood.

RTP: Their signs are up in the broker's capacity as the representative of the landlord or building owner?

Steve: Yes. Those practices aren't specialized, they represent tenants and landlords. So they know about available spaces, and they know who is moving where. If you have a site-specific requirement, it is better to choose a local broker.

Jonathan: If there are multiple real estate properties or projects within the nonprofit, you want someone who is interested in the entire relationship whatever that relationship is with the client, not just in the biggest piece. Some of the smaller pieces might be smaller than something that the brokers typically handle, but if they are interested in the entire relationship, that shouldn't be a problem. I would run in the other direction if it is someone who is only going to take the biggest piece and let you worry about the rest.

RTP: For some not-for-profits, the small assignment might be the only one they have. Does representing not-for-profits have other rewards that the not-for-profits should keep in mind when they seek advisors?

Steve: When you are a smaller nonprofit, you have to struggle to find good advisors.

Jonathan: My experience with not-for-profit boards is that often they will end up settling. They will think that they cannot get premium advice. And with real estate brokerage, often, as Steve said, the not-for-profit as tenant isn't paying [for the advisor], the landlord is paying. You should be able to go to anyone in town.

Nonprofits also have one advantage. Ours is a relationship business. What nonprofits bring, but they don't realize that, is relationships. That is worth more than the deal, or the size of the deal, or the value of the commission that can be generated from even a small deal. They bring that value to the transaction beyond the monetary value of the potential fee.

Steve: Even small nonprofits may have great boards, for example. This can be an excellent introduction to a lot of people. If we do a great job on that small project, it may lead to opportunities for us down the road. I think nonprofits undervalue that.

RTP: For any kind of organization, large or small, is the process of interviewing professionals an appropriate opportunity to educate yourself and "go to school" before you select somebody? Or is it inappropriate to look at the brokerage selection and request for proposals process as an educational seminar?

Steve: I think it is very valuable. Unless somebody is an expert on your board, the nonprofit may have no idea about the process, and specifically about what the various service providers feel is their forte, and how they price those services. Somebody may have an extra project manager sitting around; you want to keep him busy. You don't know the exact details and you don't know the circumstances until you go through the process.

By the way, the RFP [request for proposal] does not need to be 500 pages long and be prepared by a global consulting firm. Just ask people how they would do their work. You will have a little bit of apples to oranges, but you can read it and then you can ask a new group of questions to compare the apples to the oranges. There is nothing worse than a big RFP from an uninformed client. I saw one RFP that was modeled from something taken from municipal contracting, with all kinds of regulations I had never heard of before, because it was taken from somewhere else.

RTP: How do you feel in an RFP process, where you are inevitably educating somebody and giving them ideas about how you would approach the project, if you are not selected? Is that still ok?

Steve: Well, it is different if they don't select anyone or if they select a competitor. But I think it shows our commitment to the project. If you aren't willing to become educated about the client's real estate needs, you can't talk about how you will do your work. I can't bring in my professionals to help unless we know a lot about your real estate.

RTP: What should an executive director, staff, or a board that hasn't picked a real estate professional before use as a final criterion when they pick someone?

Steve: I think personal relationship and trust. You are going to go down a path where you don't know the answers, and you are going to have to trust your advisor.

Jonathan: There is also the question of how the advisor is really going to do the work. You may think that you are hiring one person and you are really getting another. Or the project is going to some junior person, who is very junior. How junior is junior? It doesn't mean that the most senior person has to do all the work. But are they going to be engaged at the critical points?

Steve: It is also really important to get someone with the right expertise. If you are looking for a big warehouse to store the clothing that is contributed, you need to talk to an industrial broker that understands where the trucks are going to come from, and the operating details—what are the sprinklering requirements for these flammable materials that are in your warehouse? That is the farthest thing from what the office brokers are dealing with.

RTP: Once the organization is ready to hire an advisor, what makes a difference in kicking off a good project relationship?

Steve: I think that it is the executive director of the not-for-profit that should hire the service providers. The board members can often be control freaks. They want to control the whole process. So if you come into the organization hired by the board, you can be at odds with the executive director from the beginning. I have had that happen too many times.

Jonathan: Our last client was a perfect relationship. A board member came in to make the introduction, but the executive director made the decisions. When it came to key points, the board would come in and ask pointed questions, setting clear boundaries, but let the executive director run the show. From the beginning, the executive director knew that this was going to be a learning process for her and for some members of the board, and we were willing to go through that learning process with them.

Steve: That's the walk down the lane.

Jonathan: Yes. And the executive director was great. When it finally came time to execute, the board had already made their instructions pretty clear and allowed the executive director to execute the transaction at the end. The board said we trust you, we've made our policy decisions, but you are the executive director and it is time for you to execute. That was a great working relationship.

Steve: And the board supported her.

RTP: If an organization faces a special project, they may think that they need to add professionals with the right skills and put them on the board. Facing an upcoming real estate project, that might be real estate brokers, design professionals, or lawyers for example. And at the same time, there is this other conversation going on in academia, about effective governance, that boards tend to be too big to be effective. What is your view about whether you need to have subject matter people on the board if you don't have them on the staff?

Steve: Organizations do tend to look inside, on the board. I can think of one not-for-profit where they told us, in essence, "I don't want to engage with you, we might get a cheaper rent on our own, and we have the expertise on the board." Do they really have the expertise on the board? Meanwhile the organization may have a small executive committee that has run wild. And then there is political stuff that goes on at the board, where you really want someone impartial.

Sometimes the board members may think that they know something they don't know. The board member might be a developer of small industrial buildings, 5,000-square-foot projects. He may not understand the complexities of the bonds involved in the nonprofit project being implemented. He may not know anything about regional infrastructure, or working for example with the County of Los Angeles. The board may expect him to know a lot more than he does. Depending on the people and the situation, he might just make it up, because they had brought him in because he was a real estate guy. He knew about 5,000-square-foot projects in real estate.

RTP: What about deciding whether to own or lease? Every situation is different, everybody has their own view about it, and it is a very complicated subject.

Steve: For many, many organizations, it is about avoiding capital investment and renting space as cheap as you can.

RTP: Should you accept and be resigned to the fact that sometimes your rollovers, your lease renewal dates, are going to come at inopportune times in the market? Is that just part of the reality of being a renter?

Steve: Yes. And how long a lease you want depends on your organization, what you are doing, your financial situation, and your confidence in the future. If it is a soft market like now, you may want the longest lease you can get to take advantage of the lower rents. There was a recent article in *The Wall Street Journal* about municipalities in California taking advantage of a down market to take space for their own needs. You have to act opportunistically. But, of course, then you are financially committed for the term.

Jonathan: If you look at nonprofits as a business, except that there are no stockholders, the business should be driving the real estate decisions. If there is a good business reason to own the property, you should buy. If not, then you lease. A lot of the challenges they face are the same questions as any other business. Do you lease, do you own, short or long, do you hire an advisor or not? It is the same as any other business.

Steve: For most nonprofits, owning your building is an endowment. It means you are safe, you are never going to get thrown out. That can be very, very significant to a rescue mission or social service organization where it may be very difficult to find the right space.

But nonprofits that own their real estate may go through never-ending reviews and never-ending discussions about what to do with their owned real estate. What if every month a developer shows up and says that he could put a high-rise on this site and give you free space? It is very difficult to come to a consensus to agree on value and to deal with all of the unknowns. The organization may think of it as selling the nest egg.

Jonathan: I can also think of a situation where someone donated a property to the organization, and the board didn't want to give it up for some reason. But there was really no business reason for them to own it; they might as well have liquidated it.

Institutions need to be very clear with people about what they need, and also to be prepared to liquidate assets they are given. Smaller organizations can be dumping grounds. Larger organizations can be dumping grounds. I have worked with some institutions that had a policy to liquidate the donated asset the same day. I have also worked with institutions that talked with a board member, a potential donor, for over a decade to get what they felt was the right gift of real estate that fit the mission of the organization.

Steve: What comes to my mind is a nonprofit that had an amazing large piece of property. It was way too big for them and it was very inefficient. It was also costing them an arm and a leg every time a circuit would break or an air-conditioning unit would go out. But they couldn't bring themselves to sell it. They kept borrowing to improve it and they went part of the way down a very expensive process to get it rezoned for development. Beyond a point, they weren't able to keep funding that process. Then the market crashed around them because they had very bad timing. Everything that could go wrong did go wrong.

They had this unnatural love for this property. They thought the environment at this site was central to their future and it really wasn't. In fact, one of their competitors went into a three-story office building in an industrial part of town and is thriving.

Jonathan: If you are a grassroots organization, you may face different challenges. Some organizations are not able to move from being a grassroots, founder-driven organization to a broadly-run institution, beyond the "founder syndrome." Those organizations may sometimes not want to deal with professionals. The founder may be there, and sometimes the founder is very controlling. That is a reason why we have 1.6 million nonprofits. Some can't get beyond that transition.

RTP: What about long-established, single-site organizations, such as places of worship? In my own research, I sometimes categorize these organizations as "location bound" because they are tied to the local community and also perhaps to their property investment. Yet many mainstream religious denominations find their membership declining.

Steve: A very large chunk of the charitable money in the United States goes to religious institutions. So we have a congregation. The parishioners aren't there any more. They are keeping the building, but they have a satellite campus elsewhere. There are two other churches down the street. Even an institution that is a fixture in the community may find that the community is no longer there. I am not saying that they should not have bought a building; you are in the community and you want a presence. But demographic changes affect this.

One of our competitors even has a religious organization practice group. You have never seen an uglier group of properties, churches, and parsonages, than these guys sell. Many of these religious organizations may also have restrictions on what the property can be used for even after they sell it, and that can be problematic. It varies.

Once in a while, a real estate solution emerges. The Crystal Cathedral is in foreclosure, and is being acquired by the Archdiocese of Orange County. They are one of the biggest Archdioceses in the country now, something like 1.5 million Catholics.

RTP: How about facilities management for properties the organization may own? If you look at the big institutions with campuses of their own, they either have staff or they outsource. But let's say you have just placed your client in a small facility, either acquiring a building or leasing one where they have some responsibility for janitorial or other operating tasks. How can small organizations manage facilities? I assume many of them are too small to outsource to big firms?

Steve: I don't know. We are working with this major regional hospital association, and as a separate business they provide guard services to hospitals. It is essentially a collective. There are some 50 hospitals in this group. They have 6,000 people working for this guard service company. Even if you are a small not-for-profit, there may be somebody out there who is in the business of providing services to small nonprofits. If you get enough of them, it works.

RTP: Assuming you have funds or reserves for needed repairs, can you save your ammunition and buy smart in a construction downturn?

Steve: I don't think so. I don't think people can anticipate when the cycle is going to go up or go down. And I think the nonprofit's performance is consistent with the cycle. So now when things aren't very great, they don't have as much money. Maybe they should save when times are good. Or go into buying groups with other nonprofits that have similar needs. The small guys have to band together. They can share space. They can share the copier machine.

RTP: One of the things we talked about at our Rooftops Conference in New York is the challenge of raising funds for ongoing or deferred property maintenance, what I call the "Mr. and Mrs. Joseph Smith boiler" problem. Many donors may respond more readily to a campaign for a new building or an addition, but not as much for funding repairs that if done well may not even be noticed when people come into the building.

Steve: Many nonprofits misunderstand how expensive it is to be an owner and operator of real estate. They are just terrible at estimating these costs, basically.

RTP: So you get surprised when you haven't budgeted. So what do you do when you are trying to raise money for unglamorous things like the boiler replacement?

Jonathan: That is always the challenge in fund-raising. You want to raise it for something sexy, but you also have to run the organization, and no one wants to pay for operating or administrative costs. I was a professional fund-raiser in my former life, for large institutions.

RTP: But they needed new roofs, too.

Jonathan: Yes. And they were building new buildings. But I was raising money for the annual fund. The focus was on cultivating relationships, and large gifts. But they would also identify their priorities.

The donors have to be educated that they are supporting the mission of the organization. There is the question of whether the donor is designating the gift or not. The more the money goes up, the more people want control. Designated or restricted gifts are problematic, especially for small organizations.

Nonprofits can also suffer from the notion of pleasing everyone. These are competing interests that many businesses don't face.

Note: The personal interviews in this paper were edited for content and space.

James Hagy is Distinguished Adjunct Professor of Law at New York Law School. He also founded and directs The Rooftops Project at New York Law School's Center for Real Estate Studies. More information about The Rooftops Project and Professor Hagy may be found at www.nyls.edu/rooftops.

The author and copyright holder may be contacted at james.hagy@nyls.edu.