



Information Asymmetry, Lease Incentives, and the Role of Advisors in the Market for Commercial Real Estate

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Introduction

- Especially in thinly traded, intransparent markets, bargaining plays a crucial role in the formation of prices (Harding et al., 2003).
 - Typical example: office market
 - 48.9 million square feet of new office supply in 2016, \$30 per square foot, multi-billion dollar market
 - finding good tenants is an important business
- Strategy of landlords: incentive payments



Introduction II

- Not much academic literature on determinants of lease incentives. This paper aims to fill this gap.
- Unique data on lease incentives (rent-free periods/rent discounts).
 - Amsterdam Taxing Authorities (survey)
 - Office market, 2002-2012
 - Building/location/transaction-specific characteristics, we also know something about subjects involved:
- Type of landlord (institutional/private) & advisor (landlord/tenant)



What would we expect?

- Private landlords give less incentives than institutional landlords.
 - Private owner more performance oriented.
 - Institutional landlord cares that property is rented out.

- Advisor on the side of tenant increases incentives, a decrease if on side of the landlord.
 - Effect for tenant higher?
 - What happens when both use an advisor?



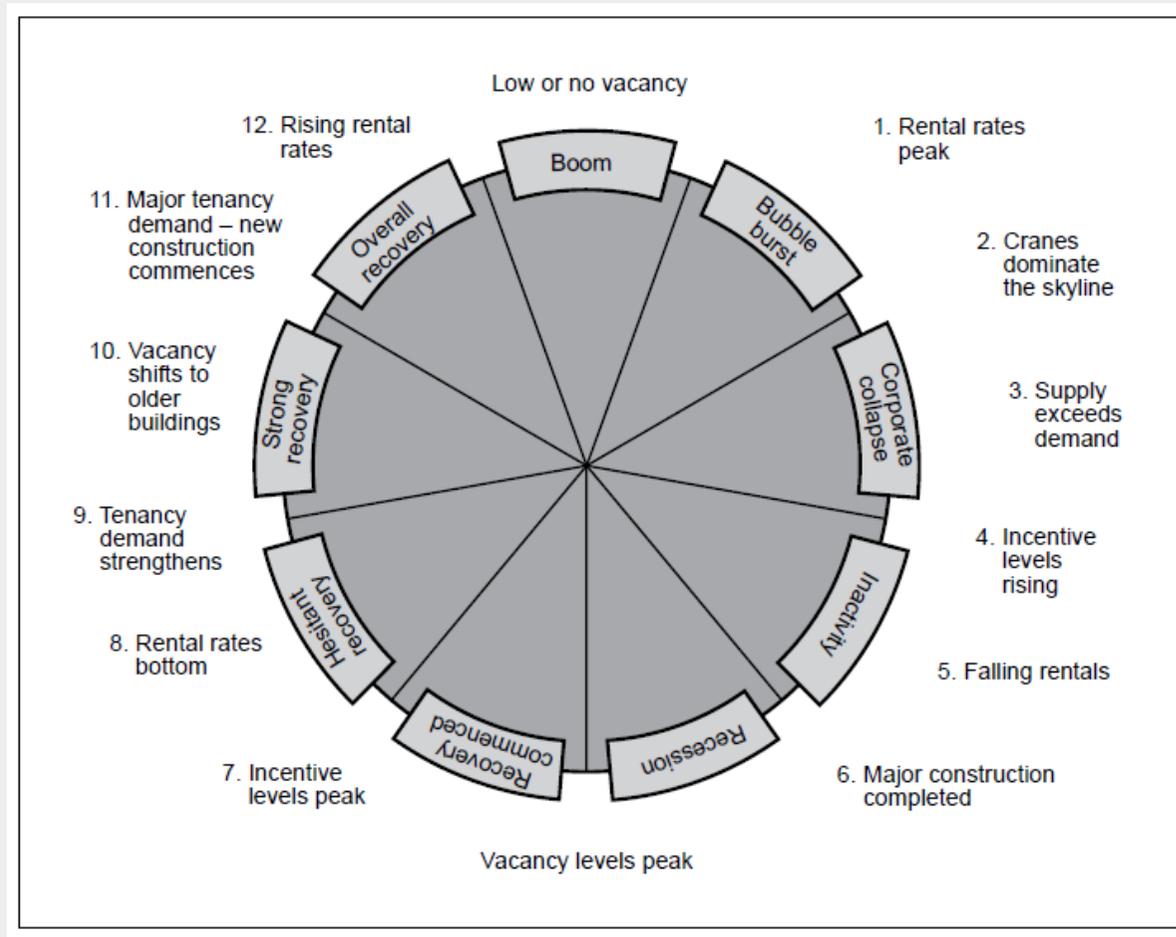
Previous literature

- Harding et al. (RESTAT, 2003): bargaining in residential real estate.
 - commercial real estate
 - direct measure of bargaining outcomes
- Garmaise and Moskowitz (RFS, 2004): information asymmetry and transaction prices

Buyers reduce the asymmetric information by a variety of strategies including only buying properties that are nearby.

-But what about the use of advisors?

Variation in lease incentive over time

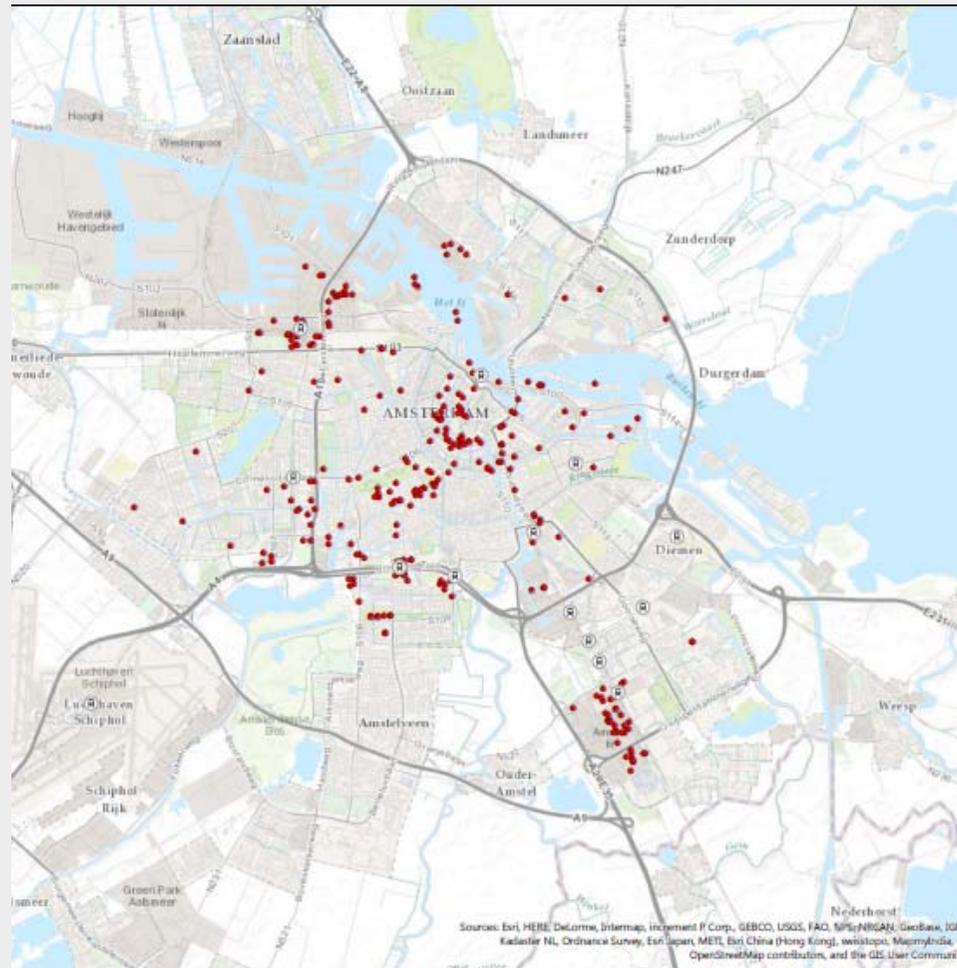


- Bond (1994), boom-bust cycle



Data: Amsterdam Office Market 2002-2012

- 409 transactions, LFA > 500 m²





Data: Amsterdam Office Market 2002-2012

■ 3 main issues:

- Only information on rent free periods and rent discounts.
- Observations without incentives.
- Loss in observations if type of landlord and advisors are included in the analysis.



Data I

Table 3 — Types of incentives

• One or more rent free periods	(This study)
• Rent discount (typically the first few years)	(This study)
• Fit out contribution and/or 'turn key' completion ^a	
• No re-delivery obligation ^b	
• Relocation allowance	
• Physical adjustment of the property on request of the tenant	
• Signing bonus and/or other payments (money at free disposal)	
• Option on released vacant office space	
• Escape clauses	
• Limit/cap on service costs and/or rent indexation	
• Share in the development profits after sale by the developer to an investor	
• Pay for less square meters than the actual rented square meters	
• Other incentives ^c	

Source: Van Gool (2011). a) Completion including installation package (partitions, carpeting, etc.). b) The tenant does not have to remove the installed amenities and/or does not have to deliver the office space in shell condition. c) The landlord takes over a previous rental contract, extra flexibility in rental contracts, the provision of additional services (shuttle bus service, exclusive advertisement rights).

- We only focus on new lease agreements.



Data II

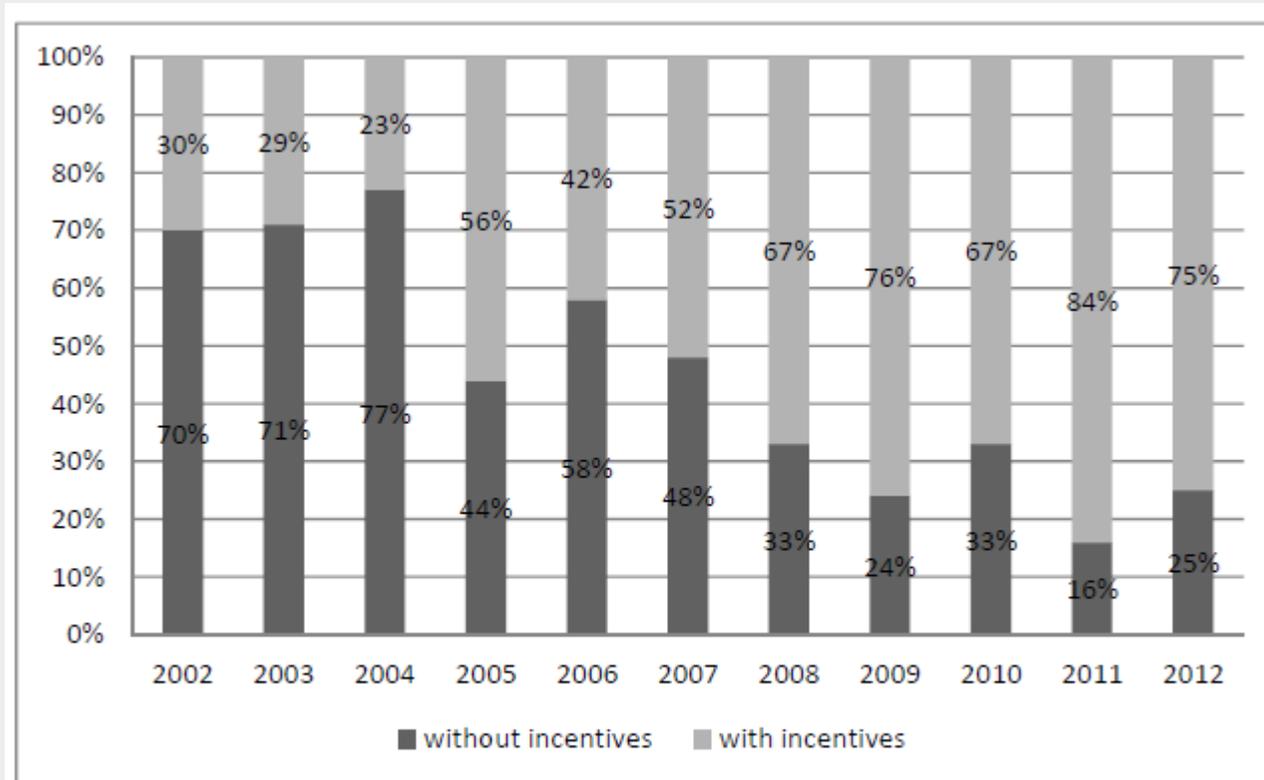


FIGURE 4 — TRANSACTIONS WITH AND WITHOUT INCENTIVES

- Not OLS, use Tobit.



Data III

$$CF_{it} = \sum_{t=1}^T \text{Initial rent}_{it} (1+i)^t / (1+r)^t$$

$$\text{Lease incentives}_{it} = (CF_{\text{rental contract},it} - CF_{\text{corrected for incentives},it}) / CF_{\text{rental contract},it}$$

- Incentives are in present value terms.
- Average excluding zero's: 16 percent.

$$\text{Lease incentives}_{it} = \beta_0 + \beta_1 \text{Landlord}_{it} + \beta_2 \text{Advisor dummies}_{it} + \beta_3 \text{Controls}_{it} + \varepsilon_{it}$$

- Size transaction, travel time, distance station, walkscore, construction year, high/low building, single tenant, lease term, year dummies, location dummies.



Data IV

TABLE 3 — DESCRIPTIVE STATISTICS

	Mean	Std. Dev.	Min.	Max.
Percentage lease incentives	0.082	0.117	0.000	0.414
Effective initial rent per m ²	169.81	82.88	30.32	519.79
Size transaction (m ²) ^a	1711.11	2385.83	500	22122
Travel time to highway (minutes) ^a	4.24	2.86	0.27	12.30
Walking dist. to station (meters) ^a	1589.64	940.90	4.14	6015
Walkscore (1-100) ^a	75.67	16.30	27	100
Landlord (institutional/private) ^b	0.60			
Advisor tenant (only) ^c	0.07			
Advisor tenant	0.64			
Advisor landlord (only) ^c	0.23			
Advisor landlord	0.86			
Advisor both ^c	0.61			
No advisor (reference cat.) ^c	0.08			

- Type of landlord: 60% institutional
- Advisor 4 categories: 61%(b) 8%(n) 23%(l) 7%(t)

Regression results I

TABLE 6 — REGRESSION RESULTS
(DEPENDENT VARIABLE: PERCENTAGE LEASE INCENTIVES)

	(1)	(2)	(3)	(4)	(5)
	Base model (OLS)	Base model (Tobit)	Type of landlord (Tobit)	Advisor variables (Tobit)	Landlord & advisor (Tobit)
Landlord (inst./priv.)			0.031*** (0.003)		0.103*** (0.027)
Advisor tenant				0.071* (0.041)	0.061 ^a (0.039)
Advisor landlord				-0.090*** (0.028)	-0.162*** (0.035)
Both advisor				0.027 (0.036)	-0.013 (0.043)
Observations	409	409	318	124	112
Adj. R-squared	0.34	-	-	-	-
Left-censored	-	198	159	39	35
Log pseudolikelihood	-	9.30	8.76	64.68	66.72

***, **, *, ^a significance at 1%, 5%, 10%, and 15%, respectively. Clustered (at office market location) standard errors in parentheses. The coefficient estimates in column 3-5 are the marginal effects conditional on positive incentives and evaluated at the mean of the independent variables.

- Institutional landlord provides more incentives (3%-points)
- Advisor for the landlord, less incentives (9%-points)
- Advisor for tenant, more incentives (7%-points)
- If both have an advisor, no gain.



Regression results II

- From a lease incentives perspective: Prisoners dilemma story: Both parties cannot afford not to hire an advisor and end up incurring the cost of an advisor.
- Of course, an advisor can also help in other ways than just with incentives...



Some further results...

- Not much spatial heterogeneity: 'westelijke tuinsteden' higher incentives.
- Incentives lower if accessibility is higher.
- Incentives higher if lease term is higher (<37 months): 3 percentage points.
- Boom-bust: Incentives higher during financial crisis



Conclusion

- Determinants of lease incentives, office market, Amsterdam, 2002-2012
 - Type of landlord matters (institutional + 3 %p)
 - Having an advisor matters (7%p., -9%p, 0%p): PD story
 - Lease term, accesibility, and economic climate matters.

- These results highlight the crucial role of market information, information asymmetry, and bargaining in the market for commercial real estate.



Thank you!

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