

Cutting Out the Middleman

By JULIE NAKASHIMA

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When technology finally began to be embraced by the commercial real estate industry, it raised the notion — tantalizing to some, terrifying to others — of a fully automated marketplace for transactions.

At conferences, panel after panel discussed the technological implications for the industry, and even coined a term for the threat that technology posed in particular to the brokerage community. "Disintermediation" would render brokers all but obsolete as Internet-based "buyer matching" services such as LoopNet's LoopLeads, www.COMPS.com's RealBid and www.PropertyFirst.com gave principals access to brokers' main stock in trade — information.

Obviously, this never happened, given that the brokerage community is still alive and kicking.

Moreover, the ability to buy real estate with a few clicks of a mouse has been elusive at best. But one company is coming close. Newport Beach-based Nexregen LLC, a real estate investment vehicle, was founded to sell interests in commercial real estate to small investors without using "commission-based middlemen" through a proprietary Web-based system.

Nexregen, which stands for the Next Real Estate Generation, is targeting potential investors who possess the real estate wits to make their own investment decisions without the advice of a financial planner.

As the company Web site states: "Nexregen believes that with the ease of access to the Internet and the transparency of the Internet, it can deliver a real estate product to the market that has 10 percent more of the investment actually being invested in the real estate rather than being paid to others in the form of commissions."

Ray Wirta, a former chief executive of-

ficer of CB Richard Ellis, serves as chairman of the company while Harold Hofer, a nonpracticing lawyer with more than 25

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years of real estate experience, is the chief executive officer. The two met in 1994 when Hofer sold a company to Koll Management Services, a company Wirta headed at the time that was later acquired by CB Richard Ellis.

Hofer explained that Nexregen's premise is to raise money from small investors in the form of a real estate investment trust, without using the commission-based financial planner/broker-dealer community. The company's goal, he said, is to drive traffic to its Web site by advertising, word of mouth, Google searches and the like.

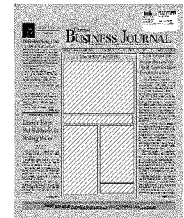
"Once they get to the Web site, they can subscribe for shares entirely on our Web site without having to communicate with a live person, if they don't want to," Hofer said. "They can pay for their shares on the site with PayPal."

Hofer believes Nexregen is the only real estate investment vehicle that allows buyers to do this. Currently, it is offering shares in a private REIT that's available only to Texas residents, relying on an intrastate exemption from the Securities and Exchange Commission. The company's minimum investment is \$2,500.

The REIT owns Firewheel Village, a 148,870-square-foot shopping center in Garland, Texas, that Nexregen acquired last May in its first acquisition. Big Lots, Hobby Lobby and Tuesday Morning anchor the project, a former Wal-Mart store that was expanded and then divided into individual stores.

Hofer observed that companies like Inland and Wells Real Estate Funds, among others, are doing the same thing on a national scale, using commission-based financial planners and broker-dealers.

"Last year, they raised over \$10 billion from investors, they being the top 10 sponsors in that sector — people that are selling small shares in private REITs like we're doing," Hofer said. "Except they're using commis-



sion-based financial intermediaries to direct investors toward them.”

Nexregen, on the other hand, is targeting small but relatively sophisticated investors who can make an informed decision without the recommendation of a financial planner or broker-dealer.

“They would look at Inland’s or Wells’ current offering and our current offering, and make an investment decision on their own,” Hofer said. “Because of our lower front-end fee structure, we think that those investors would find our offering more compelling.”

He said Nexregen’s front-end fees — 3 percent on equity, reimbursement of expenses and a 1 percent acquisition fee on the real estate value — are less than half the average charged by the top 10 sponsors in that space. The company does not pay commissions.

“More of their investment dollars are going to be invested in the real estate they’re buying, rather than being paid to a financial adviser,” Hofer said.

Technical Difficulties

Apparently, it’s not so easy to digitize the real estate business, though many have tried. Some years ago, CB Richard Ellis, Jones Lang LaSalle, Insignia Financial Group and Trammell Crow formed a joint venture called Project Octane that was conceived as a tool for online transaction management, among other functions.

The collaboration’s genesis was to prevent the big firms from being so vulnerable to the online commercial real estate databases like LoopNet and Costar, according to John Combs, principal of RiverRock Real Estate Group and the former president of U.S. Property Services for Insignia/ESG Inc.

“Octane was a consortium of these big companies [that were] trying to share resources and determine a faster, better way to use technology in day-to-day real estate, from a transaction component to a purchasing component to data management,” Combs said.

The transaction component, which was also going to include market information, was complicated to create and never took off, Combs said.

“The one that got the most traction at the end of the day was SiteStuff, which was the

procurement model,” Combs said.

However, its growth was stunted. Smaller firms didn’t want to support it because it was owned by the big players, and so following a series of transactions and mergers, SiteStuff ultimately was sold to Santa Barbara-based Yardi Systems Inc.

Combs also recalls real estate firms looking into technologies like business intelligence or intuitive software that could guess what the user wanted.

“None of that came about, even on the residential side,” Combs said. “Models were made and millions spent, and it never came together, as far as I know.”

Brokerage firms are still leery of technology platforms that take the broker out of the transaction. Two years ago, the Irvine-based retail brokerage firm Faris Lee Investments introduced the FLI Exchange, an online service that gives private investors as well as brokers instant access to the firm’s retail investment trading floor and its crack team of senior-level advisers.

According to Faris Lee’s president, Rich Walter, users can enter the site 24/7 and input their needs for retail real estate, and the information then is disseminated across the company’s entire trading floor. An FLI Exchange coordinator tracks all the inputs, and the firm’s advisers immediately go to work matching their needs against every piece of property in the firm’s inventory.

That’s followed by a personal phone call, or the clients are directed to the firm’s Web site where they can view those particular assets.

“We don’t really believe in the Internet facilitating a transaction, but rather facilitating communication,” Walter said.

At a typical brokerage company, he said, an investor would call a particular broker, who would then talk about his or her particular listings. FLI Exchange is an open platform that allows users to be as specific or as general as they want.

“This is not a commodity market, especially today,” Walter said. “Therefore, it’s very important that the assets we match are the right type of assets for the owner’s real estate needs — what his long-term goals are, what his business plan is. We want to under-

stand exactly what they're looking for, what their style of management is and what their threshold for risk is."

FLI Connect, the brokerage firm's "war room," is another communication tool where buyer and seller can archive all the reports and property-specific and client-specific information and have access to it, along with all of their accountants, attorneys, consultants and other professionals.

"Whoever is involved in a transaction with them can get very high-level, secure access to this information in order to transact the deal," Walter said.

No Replacement for Relationships

According to Walter, principals to a real estate transaction need quality representation, particularly now, when there's so much flux in the market and people are being challenged by financing and pricing.

"There's not a lot of value in putting two principals together to transact business," he said. "It's very difficult to differentiate assets when you don't have the ability to sit down with somebody, or for that matter, walk the site with them."

As for investors buying real estate by pushing buttons on a computer keyboard, Walter agreed it hasn't really happened.

"I don't think it will happen because they want that advisory," he said. "They want that protection. They want to know that there's a negotiation, and there's no better way to negotiate than to have professional negotiators."

Is it a good idea for investors to be able to execute real estate trades online?

Dave Wald, principal of Los Angeles-based Wald Realty Advisors, said it is entirely a function of whoever is doing the investing.

"To the extent someone isn't an expert and is removed from the real estate by virtue of dealing strictly through a Web site, something like that would pose all sorts of challenges," Wald said. "Like any other investment, if you know a lot about it, then

you can have an understanding of all the challenges and opportunities that it offers. If you don't, you're better off getting someone else to help you."

Nexregen does encourage potential investors to "see before they buy."

"Our goal in buying the first property is to have an identifiable asset that prospective investors can touch and feel," Hofer said. "People can know what they're buying and actually go by and see the property if they want to."

But has the premise been a successful way to sell commercial real estate interests? According to Hofer, the response has been positive so far, although sales of the offering are a little behind expectations.

Nexregen purchased Firewheel Village last May and received a one-year permit from the Texas State Securities Board to sell the offering in September. The offering was two-thirds sold halfway through that period.

"I think the smaller investors' perception, or maybe everyone's perception, of real estate is not as rosy as it was at this time last year," Hofer said. "That's affecting our sales."

Nonetheless, Nexregen is negotiating on another shopping center in Dallas. As the first property gets closer to closing out, he explained, the company wants to have the next property in the pipeline and ready to go so there is not a lot of downtime between offerings.

Although Nexregen is focusing on Texas now, Hofer said the firm plans to file a registration statement with the SEC later this year for a national offering with a 2009 launch date. The company will target office, retail, industrial and multifamily properties.

According to Hofer, Nexregen's advantages are its lower fee structure, which means more dollars invested in the real estate, as well as the novelty, the ease of use, the transparency of the Internet, the sponsorship and the property's performance.



PHOTO COURTESY OF NEXREGEN LLC

Newport Beach-based Nexregen LLC owns Firewheel Village, a 148,870-square-foot shopping center in Garland, Texas. Nexregen is offering shares in Firewheel Village through a private real estate investment trust that is available only to Texas residents.