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FIRST PERSON

RECENT ACQUISITIONS

THE MARKET FOR BROKERAGE FIRMS

Recent brokerage sales and mergers give insight into the market.

by Steve Murray, publisher

In the last few months, several significant acquisitions were completed. HomeServices of America acquired The Kentwood Company of Denver; NRT acquired Hammond Residential of Boston; Howard Hanna acquired the nation's eighth largest brokerage, Realty USA, with a presence in five upstate New York markets, and The Keyes Company of South Florida merged with Illustrated Properties of Palm Beach County. Each of the acquired firms was highly ranked, profitable brokerage firms in key markets. Each was led by talented, experienced leadership.

Varied Reasons

The reasons for the sales were varied. First, the housing market recovery is now about to enter its sixth year, and

Continued on pg2

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there is a feeling that it may soon run out of steam. Additionally, pressures on gross and net margins were making it harder to make money in the basic brokerage business.

For some of these firms and many others in the industry, operating mortgage, title and other core services businesses has grown far tougher and again margins have shrunk. In other cases, for these and other firms, regulatory pressures and potential liabilities have grown to uncomfortable levels with no end in sight. Lastly, the prices and terms being paid for quality brokerage firms by firms such as those listed above are at 10-year highs. Each of these factors is playing a role in why several privately owned firms are choosing, at this time, to trade the highly illiquid equity of a brokerage firm for more tangible assets.

SEVERAL PRIVATELY OWNED FIRMS ARE CHOOSING, AT THIS TIME, TO **TRADE THE HIGHLY ILLIQUID EQUITY OF A BROKERAGE FIRM FOR MORE TANGIBLE ASSETS.**

Waves of Change

Every industry goes through waves of change. As most industries mature, consolidation occurs. Whether you look at health care, auto manufacturing, banking, insurance, steel or cable TV, as time goes by, there are fewer significant participants in the market. While residential brokerage saw its first acquisition wave in the late 1970s, and the huge growth of franchising in the 1980s and 1990s, even today, the eight largest national brands control less than 50 percent market share, and the five largest independently owned brokerage firms control less than 10 percent of the national market share.

While several of these entities control larger shares of certain metropolitan markets overall, brokerage remains highly fragmented.

RT 500 Gains Market Share

We did note that in 2015, the REAL Trends 500 gained market share for the first time since we published the rankings over 30 years ago. Historically, when the housing market was strong, while the larger brokerage firms grew, they tread water or slightly lost market share. This was due to the ease of top agents and managers leaving established firms to start their firms. Last year, the largest firms gained share, but also, our numbers indicate that they outgained the national market by 5 percent. That is a huge shift—particularly in one year.

Rapid Growth in Teams

Another trend moving the industry in this direction is the rapid growth of sales teams and the amount of business that teams are doing. The number of teams ranked on REAL Trends America's Best Agents went from slightly over 2,000 three years ago to over 4,000 teams this year. They had to close at least 75 transactions or $30 million in volume to be ranked. There were over 60 teams that did have enough business to be ranked on the REAL Trends 500 and Up-and-Comers rankings, which require at least 500 closed sides. Also, the majority of teams are affiliated with national brands or large regional brokerage firms. Thus, we see a trend where teams grow larger and, in turn, help their firms grow larger and faster than before.

While the market is cooling a bit, particularly in the upper end, it appears that the market will continue to perform well for the foreseeable future. Pressure on gross margins and net margins, the inability of medium- to small-sized firms to access mortgage and other core services profit and, to some extent, pressure on the commission rate due to the scarcity of inventory will continue to push the industry into fewer larger firms in the future. Just as other industries have matured and consolidated, so too will residential brokerage.

AMERICA'S BEST REAL ESTATE AGENTS REALTRENDS

The number of teams ranked on REAL Trends America's Best Agents went from slightly over 2,000 three years ago to over 4,000 teams this year. They had to close at least 75 transactions or $30 million in volume to be ranked.

NINJANOMICS

CREATING THE VALUE DRIVEN ORGANIZATION

Focus on the investments that give you the greatest return.

By Larry Kendall, author of Ninja Selling and chairman of The Group, Inc.

"Our true worth is determined by how much more we give in value than we receive in payment." This is the Law of Value from Bob Burg and John David Mann's book The Go-Giver, and it serves us well whether we are an owner, manager or sales associate.

Owners

As an owner, adopt the mindset of what we call *Ninjanomics*. There are four rules:

1. There are no expenses.
2. There are only investments.
3. Every investment must have a return on investment.
4. Focus on the investments that give the greatest return on investment.

Don't look at your employees, marketing or facilities as expenses. Instead, look at them as investments and expect a return on those investments. Invest in them and expect a return. If you aren't getting a return, they are expenses, and there should be no expenses, only investments.

Managers

As a manager, adopt the *Ninjanomics* mindset, as well. Your owner is investing in you, and you need to provide a return on that investment. It is how you make yourself valuable to the organization.

Are you generating more gross commission income (GCI) in the form of referrals, builder accounts or relocation accounts than your salary? How about recruiting? Are you recruiting more GCI each year than your salary? How about coaching your sales associates to higher levels of productivity? Your true worth is determined by how much more you create in value than you receive in payment.

Don't look at your employees, marketing or facilities as expenses. Instead, look at them as investments and expect a return on those investments.

In recruiting, sales associates are attracted by value. Can you articulate your value proposition? Typically, they value and are willing to pay money for two things: to solve a problem (pain); and to feel good (pleasure). Two great questions to discover their pain and pleasure are:

1. "What is your greatest challenge in your business right now?" (Solve their pain.)
2. "If you could wave a magic wand and have your business just the way you want it, what would that look like?" (Help them achieve their goal—pleasure.)

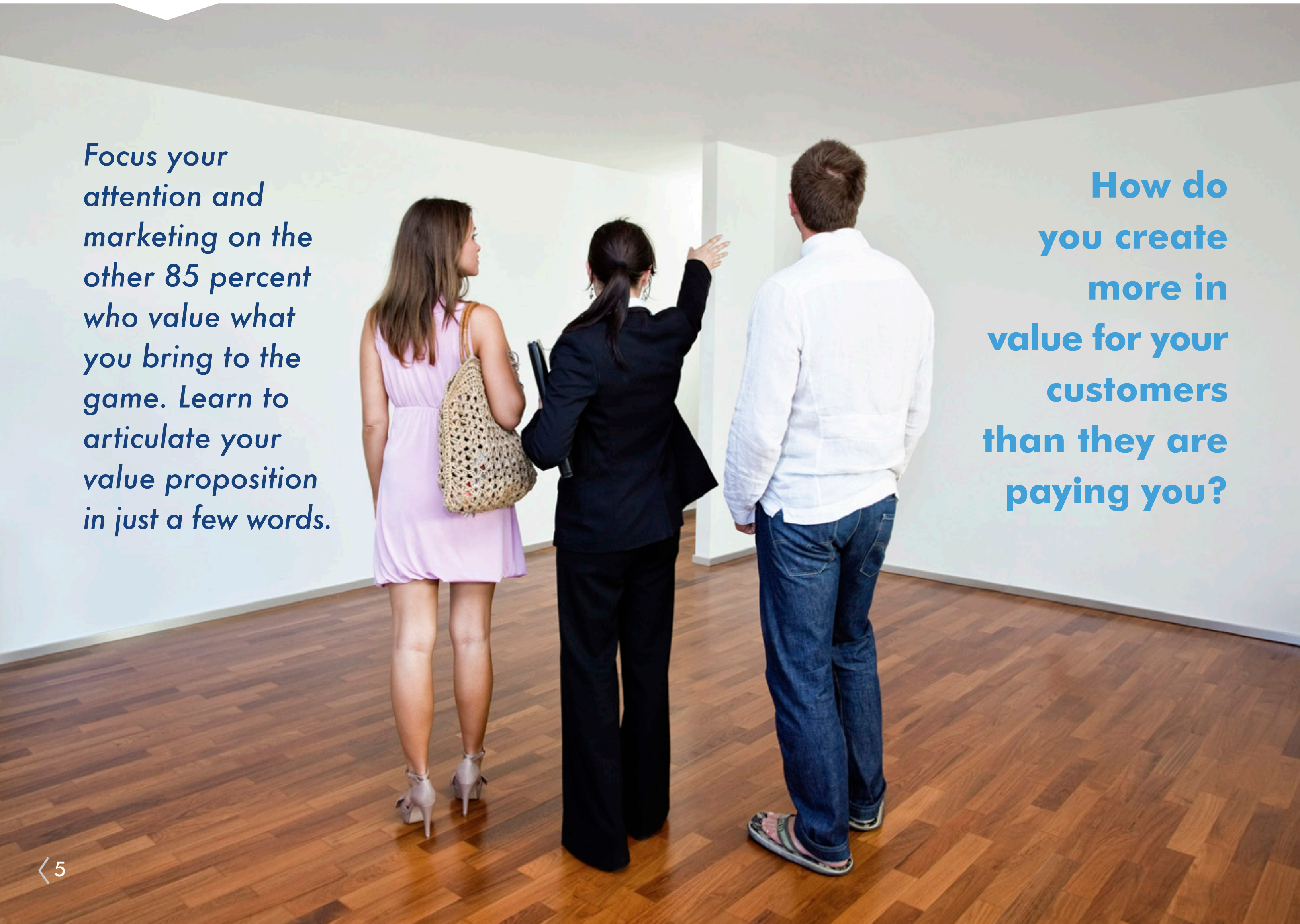
Sales Associates

Unfortunately, there's a group of customers who do not care about value. About 15 percent of the U.S. population make all buying decisions based on lowest price—period! They don't care about value. As a sales associate, we recommend you let this group work with someone else. These customers tend to be grinders and will steal your time and energy as they try to squeeze every drop of money out of you and the transaction.

Instead, focus your attention and marketing on the other 85 percent who value what you bring to the game. Learn to articulate your value proposition in just a few words. How do you create more in value for your customers than they are paying you?

In my experience, most sales associates need help in this area. You bring tremendous value, but you may not necessarily know how to articulate your value to a customer—specifically to a seller who asks you to discount your fee. We'll give you some tips on how to articulate your value proposition in next month's issue.

When everyone (owners, managers, sales associates, and staff) have the value creation mindset and actions, your organization will attract and keep the best talent, the best customers, and be highly profitable as well. You have created a value driven organization.



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How do you create more in value for your customers than they are paying you?

BUSINESS MODELS

IS THE MARKET RIPE FOR NEW ONLINE MODELS?

A plethora of new, yet familiar, online models are popping up. Check them out.

By Tracey C. Velt, editor

In August 2015, Steve Murray wrote about the explosion of new business models. In that article, he says, "Is the killer app for residential real estate now on our doorstep, and we just don't recognize it? After all, how can all of the billions of dollars that have been spent by venture investors be justified? Are they all wrong? Why do so many think that there is a gold mine in brokerage that would warrant such intense interest by technology firms and their backers?"

At the time, Murray wrote, "Has anyone truly proposed a better service package in buying or selling a home than one can get from a competent agent with a decent transaction management system behind them? Has anyone delivered a superior way for consumers to find a home than is already available through thousands of real estate websites? Has anyone delivered a system that is so demonstrably better than what is available through the careful choice of a qualified agent? Can they do so and lower costs significantly enough to matter to consumers while doing so? No, we don't think so either—not yet anyway."

Here, we outline four companies and what they have to offer. Some are new, some are not, but the one thing they all are is similar. **Will they disrupt the market?**

Here, we outline four companies and what they have to offer. Some are new, some are not, but the one thing they all are is similar. Will they disrupt the market? The jury is out, but they sure will continue to try. After all, they all offer some discount on commissions at a time when a survey by Redfin found that 60 percent of home sellers now save money on commission (see page 8 for the study.) Here are some recently tweaked or released models:

Zeppidy

Zeppidy is a home buying and selling platform that offers consumers and agents more simplicity, transparency, and a streamlined experience throughout the real estate transaction—from initial search or listing to closing. "We provide agents capabilities that help deliver a fresh modern experience that differentiates them in the rapidly evolving consumer driven marketplace. About 80 percent of the platform capabilities are focused on delivering the next level of client experience. Agents save time on client support tasks and backend brokerage compliance is easy for them," says Gary Schultz, founder and CEO.

Property inquires and private showing requests on Zeppidy go directly to subscribing listing agents and home owners. The way the Zeppidy platform organizes citywide Neighborhood Showings® provides listing agents a convenient way to drive more showings at designated times every week, and buyers a low-pressure shopping experience.

When consumers are ready to engage professional representation, they can request a referral within the platform to an independent real estate agent. Zeppidy contacts these consumers directly to find out about their current needs and pairs them with one of the Elite local independent agents with whom Zeppidy is partnered. "Agents who subscribe to our service annually are eligible for our Elite Agent Referral Program. We spend time with each agent to ensure they will deliver a superior level of service for our users."

Sellers can list their property on the platform and are committed to paying a percentage commission to a buyer's agent. "As an operational backbone in every market, we provide a limited listing service to DIY sellers and have a licensed principal broker of record in states where we operate," says Schultz.

The Zeppidy live public beta is available currently in the Oregon/Southwest Washington market with plans to start a national service roll out in the fall of 2016.

USRealty.com
Colby Sambrotto, president of two-year-old online brokerage USRealty.com, built a hybrid business model aimed at reducing transactions costs. Buyers' agents are guaranteed their buy-side commission for houses listed in their MLS. Sellers may choose the commission, but negotiable commissions are not common. Sambrotto, who co-founded ForSalebyOwner in 1998 and sold it to Tribune Digital in 2006, says, "Our brokers are members in one of 110 multiple listing services. It's a DIY approach for sellers to list their homes for sale. Buyers' agents are guaranteed their commissions because USRealty.com is an agency that fulfills the promise of MLSs for agents, homeowners and homebuyers." He says the company is "not currently hiring brokers or agents, but if you want to help us sell listings, we'll provide you with commission at or near a traditional buy side commission."

USRealty.com offers consumers free access to the MLS and gives consumers listed through their network of in-house brokers. According to Sambrotto, this allows the home seller to retain equity in their home. USRealty.com provides guidance, expertise and all the tools necessary for an easy, quick close. USRealty.com can provide access to the inventory for Boomers looking to upgrade to larger homes, but also has options that would be more appealing to those looking for a lower price point.

The brokerage is running in 33 states.

Real
"My partners and I looked at the market and realized that the agent-broker relationship hasn't changed for decades. Agents work for brokers and, in the past, it made sense because they owned the office, advertised and brought value to the agent," says Tamir Poleg, CEO and founder of Real, a technology-powered real estate brokerage.

"When the Internet came into the game and people didn't want to work in an office, we understood that the value brokers provide to agents is diminishing. Younger agents who are stepping into the market are looking for a different way to do business, a different way to communicate," he says. Poleg says Real provides value to agents through technology, acknowledging that they are small business owners. "We offer a brokerage platform that allows them to build their businesses. They should be focused on creating relationships," he says. Real, created by real estate professionals and software engineers, charges no fees and offers an 85/15 commission split. "We're not focusing on the top producers or the least producing agent. We're here to serve everyone," he says. Real provides agents with an app that handles everything from basic chat and access to leads to accessing MLS data and creating contracts. "We offer 24/7 support through the app, you get paid through the app and you can even build a website through it," he adds. So far, Real is licensed in 15 states and has 650 agents.

Owners.com
In the past, owners.com didn't have much interaction with sellers. It only offered a flat fee, MLS package for buyers. "We expanded that so our agents can take a full-service listing," says Brett Stratton, head of Owners.com Brokerage Services. "We've built out a traditional brokerage model and work with the buy side of the transaction, which we haven't been involved in since Owners was started in 1996," says Stratton. He says that Owners.com has "peeled off the things agents aren't typically good at. We manage the back office, drive the marketing, offer an inside sales team that does the vetting and then transfer the lead to the agent, so they don't have to spend so much time working the leads."

Owners does not charge sales associates a fee and they offer a 70/30 split. "We offer a 90/10 split if the agent closes a lead with his or her own sphere of influence. There are no desk fees," he adds. "We generate volume. It's a numbers game. We saw a great opportunity to go to a market where other companies weren't doing that great of a job offering a more consumer-centric experience," says Stratton.

Owners.com services are available to sellers nationwide. For buyers, brokerage services are currently available in Mass., Georgia, Fla., Ohio, Texas, Penn., Illinois and Calif., where Owners.com is actively hiring agents. Owners.com will continue to expand throughout the country. Owners.com currently is active in 8 states.

SURVEY

60 PERCENT OF HOME SELLERS NOW SAVE MONEY ON COMMISSIONS

Nearly half of buyers surveyed save on real estate fees.

Sixty percent of people who sold a home in the past year got a discount on the commission they paid to their real estate professional, according to a survey of more than 2,000 people conducted in June by SurveyMonkey Audience and commissioned by Redfin (www.redfin.com).

Among homebuyers, 46 percent said their sales associate gave them a refund or closing cost contribution of more than $100, with the average savings amount for that group being $3,693. Last year, 37 percent of buyers said they received savings from their agent worth $500 or more.

“While market forces are driving home prices up, innovation is helping to drive commissions and fees down,” said Redfin Chief Economist Nela Richardson. “These survey findings suggest that the industry is becoming more dependent on technology and less dependent on the local agent as the sole source of information about homes for sale. The fact that savings are so widespread indicates that agents and brokers are adapting by using technology to work more efficiently and charge less money.”

Last year, 37 percent of buyers said they received savings from their agent worth $500 or more.

Findings about for-sale-by-owner (FSBO) and other alternative approaches to buying and selling homes include:

- A quarter of people who sold a home in the past year did so without the help of a full-service agent:
  - 15% of sellers used a limited-service agent.
  - 10% of sellers listed their home without an agent’s help. This is slightly higher than the latest figure reported by the National Association of Realtors® that FSBOs accounted for 8% of home sales in 2014.
- People selling million-dollar-plus homes were the most likely to use the FSBO approach, with 23% going that route.
- More than half of people (54%) who sold without a full-service agent did so to save money. For those whose homes sold for $750,000 or more, the most commonly cited reason was that they didn’t think a full-service agent was necessary (41%).
- 16% of homebuyers bought without an agent’s help, little changed from last year.
- 69% of survey respondents said they are open to an alternative to the traditional real estate service, up from 64% last year.
- Asked about agent incentives, 52% of respondents said they prefer a purely commissioned agent. One-third of respondents dislike the idea of a purely commissioned agent.

For the full report and methodology including more data and insights, **CLICK HERE.**

LONE WOLF SPONSORED POST

BACK TO THE BASICS— QUALITY VS. QUANTITY

Don't make the mistake that more agents is better than fewer, more qualified agents.

By Kristen MacDonald, content specialist for Lone Wolf Real Estate Technologies

We see it more often than we would like—a new broker opens up her first real estate brokerage and immediately her mind goes to recruiting as many sales associates as possible. You may think, well, more agents, more deals, more money, right? But, there is more to the equation. And, it means going back to the basics.

Did you ever get upset as a child because Billy down the road had more people at his birthday party and half of your soccer team couldn't make it to yours? Chances are you went moping to your parents about it, and they replied with some line about how it doesn't matter how many people come to your party, or that Billy had 20 guests. What matters is that you have 10 friends coming who really care about you, and you can still have a great time with them.

Sound familiar? It's a simple principle that many of us were taught from an early age, and one that is reflective of the sustainability of your real estate brokerage – quality vs. quantity.

The reality is that there is no benefit to recruiting 50 agents to your brokerage over five agents if those agents aren't quality real estate professionals. And as a real estate broker, it's your job to ensure you have a handle on which agents are contributing to the success of your brokerage and which agents aren't.

At a first glance, you may be inclined to say that all of your agents contribute to your success and that you are set up for a record year. After all, each agent has closed more deals than last year and you have more listings than ever before. But, identifying quality agents means taking a deeper dive into their true value to your brokerage.

The reality is that there is no benefit to recruiting 50 agents to your brokerage over five agents if those agents aren't quality real estate professionals.

Commission Cutting
A great place to start when evaluating the true value of an agent is with their commission cutting habits. You may think that your highest producing agent is the greatest contributor to your bottom line, but a deeper dive into the metrics reveals that he is actually reducing his commission on multiple deals, meaning money lost for your brokerage.

Agent Net Worth
There is a base cost for each agent on your team. Training, paper, photocopies, websites, software—they all cost money. So, while your agents may be closing deals, you need to ensure their activity is enough to cover their expenses. Then, you will truly understand which agents are making you money and which agents cost you money.

Agent Performance
Understanding how your agents do business will allow you to understand better where your brokerage stands financially. A more in-depth look at agent performance may reveal that your agent who closed the most deals last year had a lower average selling price and, that, in reality, another agent who closed fewer deals did so at a higher price—making you more money.

When it comes to the success of your brokerage, there is more than meets the eye; determining the value of your agents and ultimately the sustainability of your real estate brokerage starts with the data. An investment in the tools to help you collect and understand this data is worthwhile and allows you to plan for your future success.

Any business can get complicated. It's important to remember the basics: quality vs. quantity. After all, I am sure you walked away from that birthday party with memories of a great time with friends, not of Billy's guest list.

Kristen MacDonald is the content specialist at Lone Wolf Real Estate Technologies. With a passion for writing and technology, Kristen loves exploring the latest trends in real estate and sharing her perspective with her audience.

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You may think that your highest producing agent is the greatest contributor to your bottom line, but a deeper dive into the metrics reveals that he is actually reducing his commission on multiple deals, meaning money lost for your brokerage.

PAM LIEBMAN, CEO, THE CORCORAN GROUP, NEW YORK, NY

CHALLENGES IN THE MARKET

Lessons remembered—learn from leaders where tomorrow's opportunities and threats lie.

By Steve Murray, publisher

"The market in New York has changed significantly. Buyers no longer have the strong sense of urgency they had in the past few years. Sellers remain committed to high prices. The new challenge is getting them together on the pricing. Currently, many in both camps aren't interested in helping the other party get to a solution. So, we have a time when sales may well slow down," said Pam Liebman, CEO of one of the nation's largest brokerage firms.

Liebman has been CEO of The Corcoran Group since before the firm was sold in 2001 and has engineered its rise to a firm six to eight times larger than it was when it was purchased from founder Barbara Corcoran in 2001. She retains great enthusiasm for her sales associates and for what they have yet to achieve. The firm has expanded beyond its New York City footprint and has operations in South Florida and on Long Island in the Hamptons, where many of the firm's clients have second homes.

Love of Company

"I think that my love for our company and business is founded on a few things. First, I have a great management team that allows me to do what I most love to do—visit our agents in the field and work closely with our developer clients. I still love that part of the business," she said. "When you have a great team to run the day-to-day facets of the business, it allows me to focus on agents and what's happening in the market. For me, that is fun."

She also said that she "enjoys our agents and listening to them. I try to anticipate what they

> "I think that people running a brokerage business need to stay as close to their agents as they can. It makes it all real."

need from us. Do they need better marketing? Are they having technology or operational issues? I think that people running a brokerage business need to stay as close to their agents as they can. It makes it all real."

Gauging the Competition

Finally, she said, "Having a great team allows me to keep tabs on what's going on with our competition. There are always new guys trying to do something new and less expensive. In our markets, new model competitions seem to arrive almost every month. Most don't make any real difference in the market, although some disrupt the market without really changing how the market works. My view is that CEOs have to gauge what is going on in the market with competition."

Agent Brands and Technology

We asked Liebman what has changed the most in her career. "One thing that has changed is the growth in agent brands. With the explosion in television shows based on top agents across the country, it seems like a growing number of agents are building their brands. Another issue is the rise of technology as a driver in how agents do business. When you think about mobile devices and online access to almost everything, including the processing of transactions, it's made agents flexible concerning when and where they can work. In the last 10 years, we've seen an explosion in this trend. We have to tinker with the suite of services we offer our agents, not just in technology, but in every area of our business."

Still About Relationships

Liebman said, "It seems that we remain a relationship business. Relationships with our agents and leaders, as well as between agents and their customers. For example, while we are studying the growing trends of online reviews and ratings, most of our agents tell us that in New York, almost all of their business is still based on knowing people or having friends and associates refer them to clients. Reputation still matters in our markets both here and in Florida."

She added that she thinks agents today are far more business oriented than in the past. They work smarter and more efficiently. "I've always believed that a great agent is vital to anyone buying or selling a home. They have to be, because buying and selling a house is much more complicated than it used to be."

One thing is for sure—this is one CEO who hasn't lost her passion for what she's doing and seems determined that her company's future will be more successful than its past.

"Most of our agents tell us that in New York, almost all of their business is still based on knowing people or having friends and associates refer them to clients. Reputation still matters in our markets both here and in Florida."

CFPB

IS A JOINT VENTURE A VIABLE ALTERNATIVE TO A MARKETING SERVICE AGREEMENT?

Factors to consider if you're exploring a joint venture

By Sue Johnson, strategic alliance consultant

The Consumer Financial Protection Bureau's (CFPB) aggressive enforcement against Marketing Service Agreements (MSAs), coupled with its 2015 Bulletin warning providers to "proceed with caution" in this area, has led many companies to explore a joint venture as an alternative to an MSA.

The CFPB has not outlawed MSAs *per se,* and the Supreme Court may decide this year whether or not the agency has overstepped its bounds in its strict interpretation of how RESPA's referral fee prohibition applies to this type of agreement.

But given the uncertainty of today's MSA regulatory environment, should you actively explore a joint venture? The answer is, "Maybe." Here are some factors you should consider as you begin your assessment.

1. **Will you be able to capitalize adequately the joint venture?**

   To create a RESPA-compliant joint venture, you'll need to capitalize the entity. No specific amount is required, but many RESPA attorneys recommend an investment covering start-up costs and six months of expenses. Be aware that RESPA regulators expect your investment not to be tied in any way to expected referrals. If the returns are disproportional to the amount invested, you open yourself up to an investigation.

2. **Will your volume of business support a joint venture?**

   You obviously will need a certain volume of business to make the capital investment and operational costs worthwhile. A pro forma income statement done in conjunction with your prospective partner will enable

you to assess how many transactions the new entity will need to close to cover your costs and to achieve your profit goals.

3. **Do you have a viable joint venture partner?**

   Your partner will be critical to the venture's long-term success. You could start by assessing the suitability of companies that already do business with your sales force and customers. One possible partner is a company with an established track record of creating and managing RESPA-compliant joint ventures.

4. **Are you and your partner ready to make a long-term commitment?**

   Beware of potential partners that approach you with proposals involving quick profits. A successful and compliant joint venture involves a long-term commitment by the senior management of all owners. If one is a real estate brokerage company, it takes time and excellent service to win the business of its real estate sales force.

5. **Are you ready to comply with RESPA's ABA standards?**
   First, you should comply with the three statutory conditions of RESPA's affiliated business arrangement (ABA) safe harbor:

   1. Provide an ABA Disclosure in writing at or before the time of the referral.
   2. Do not require the consumer to use the affiliated service.
   3. Do not receive any "thing of value" from the venture other than a return on ownership interest or franchise interest.

You also should not consider a joint venture unless you and your partner are ready to comply with the RESPA Sham Joint Venture Guidelines that RESPA regulators use to determine whether a joint venture is "bona fide" or a "sham" designed to circumvent RESPA's referral fee prohibition. They include:

1. **Adequate and proportional capitalization:** As discussed above, the joint venture should be adequately capitalized, with any returns being proportional to the capital investment.
2. **Employees:** It should perform its essential services with its own employees, not employees loaned by either owner. Many RESPA attorneys advise hiring at least one full-time dedicated employee.
3. **Separate management:** Its operations should be run by its own management, not the management of either owner.
4. **Separate office space:** Its office(s) should be separated from those of either partner, and it should pay market value for the space.
5. **Performance of "core" services:** It should perform the essential functions for which it receives a fee. If it contracts out services, it should pay for the fair market value of those services.
6. **Outside business:** The entity should actively compete for outside business, and not send business exclusively to an owner or its affiliates. Many states require that a certain percentage of revenues be obtained from unaffiliated sources.

Do you need to meet all of these guidelines? Not necessarily. Some, such as capitalization, employees, and the performance of core services, are considered more important than others. But you should be prepared to meet as many as possible to prevent the RESPA police from knocking on your door.

A successful joint venture can bring you long-term financial benefits and enable you to build value for your customers. But it also requires a substantial financial and management commitment, as well as compliance with a separate set of regulatory standards. If you decide to explore this option, make sure you do so with the advice of an attorney with an established RESPA practice.

TODAY'S MARKET

WHY THE BUBBLES AREN'T BURSTING

As robust demand and tight inventories drive up home prices at double-digit rates in dozens of hotter markets, warnings of local bubbles again are making headlines. Should we be afraid?

By Steve Cook, RealEstateEconomyWatch.com

As prices rise faster than incomes, some forecasters are raising fears that the crash of a decade ago may repeat itself on a local basis in metros like Denver, Seattle, Miami and Portland. The housing bust nine years ago reached catastrophic levels because millions of owners simply could not afford their mortgages. Recent reforms ended the risky and fraudulent lending practices responsible for many of the bad loans made during the boom. Though tougher underwriting standards and new ability-to-pay requirements protect consumers from a repeat of the 2007 bust, bubbles are still theoretically possible.

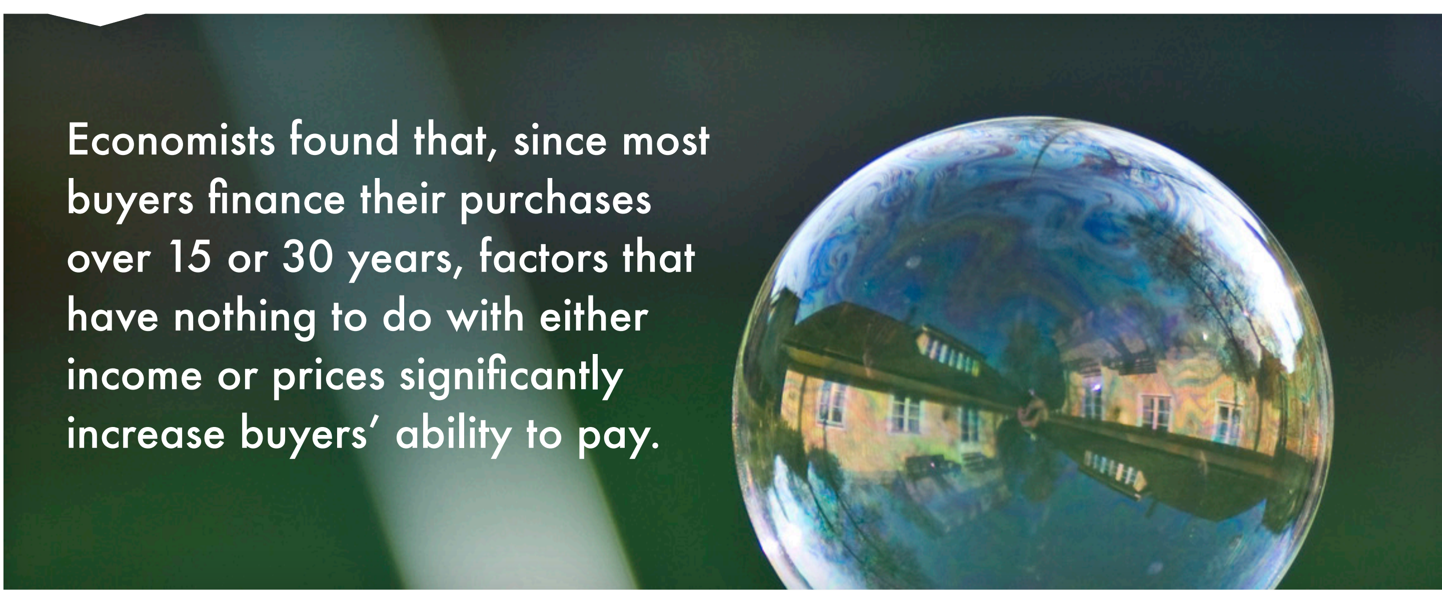
Skimpy Inventories

There's no doubt that today prices are outstripping income levels in many markets, especially on the West Coast, yet there seem to be no short term consequences. The primary brake on sales in the hottest markets is not rising prices, but skimpy inventories. If local buyers cannot afford rising price levels, why does demand remain strong? Why isn't the law of supply and demand slowing down demand and cooling off prices? If bubbles are forming, why are there no busts?

New research suggests that the reason for the disconnect between demand and prices is that simple ratios of income levels to prices do not paint a complete picture of buyers' ability to afford to buy homes. A study by three Belgian economists scheduled to be published later this year by the *Journal of Housing Economists* found that, since most buyers finance their purchases over 15 or 30 years, factors that have nothing to do with either income or prices significantly increase buyers' ability to pay. Specifically, the greatest factors that increase buyers' ability to pay for homes are the mortgage interest deduction and declining mortgage interest rates.

Value of Mortgage Interest Deduction

The economists calculated and compared the value of the mortgage interest deduction and interest rates to buyers' ability to pay in the United States, the United Kingdom, Belgium, the Netherlands, Sweden, Norway, Finland and Denmark. Three of the nations studied allow a tax benefit for mortgage interest—Belgium, the Netherlands, and the United States. The study found that in the United States, a 1 percent increase in mortgage rates from 3.5 percent to 4.5 percent decreased borrowers' ability to pay by 7.21 percent and



decreased demand enough to lower house prices by 8.61 percent. Abolishing the mortgage interest deduction (MID) would reduce borrowers' ability to pay for their homes by 17.65 percent and would lower house prices by 19.94 percent.

"Although the price-to-income ratio is a commonly used measure of housing market imbalances at many policy institutions, income alone seems insufficient to explain the evolution of house prices. As unsustainable house prices may raise concerns about financial stability, it is important to understand the factors behind the evolution of house prices. An important element is that the budget constraint depends on mortgage characteristics and the MID. An additional borrowing constraint and market clearing result in a relationship between house prices and a measure of the amount that households are able to pay," concluded Sven Damen, Frank Vastmans and Erik Buyst, economists based at Center for Economic Studies, at KU Leuven, Belgium.

Impact of Other Incentives

The study did not look at the impact that other incentives may have on increasing buyers' short-term ability to pay, especially low or no down payment mortgages. Clearly, lower down payments make it easier for buyers, especially among first-time and lower-income buyers, to buy homes. Programs like FHA stimulate demand, especially for lower-tier, affordable properties which already are in short supply. The impact of low down payment loans may be huge; they are used so widely today that the median down payment paid by first-time buyers last year was only 6 percent compared to 14 percent for repeat buyers, according to the National Association of Realtors® 2016 Buyer and Seller Report.

Buyers' ability to pay for long-term mortgages is not a simple relationship between income levels and home prices. Other factors, including incentives like the mortgage interest deduction and low down payment loan programs like FHA, are the result of public policies set by the federal and state governments. Mortgage interest rates, to the extent that they are shaped by decisions of the Federal Reserve, also reflect decisions by policymakers.

Changes in these incentives increase or decrease buyers' long-term ability to buy homes as much or more than short-term changes in the home price to income ratio. Elimination of the MID coupled with a one-point decline in rates, for example, would reduce buyers' ability to pay for a home by nearly 25 percent and home prices would fall nearly 30 percent if the Belgian study is correct. If these incentives artificially encourage and sustain bubbles, ending them would certainly bring about busts.

Elimination of the MID coupled with a one-point decline in rates, for example, would reduce buyers' ability to pay for a home by nearly 25 percent and home prices would fall nearly 30 percent if the Belgian study is correct.

DECLINES COMING?

HOMEOWNERSHIP RATE AND DEMOGRAPHY

Will the homeownership rate decline further?

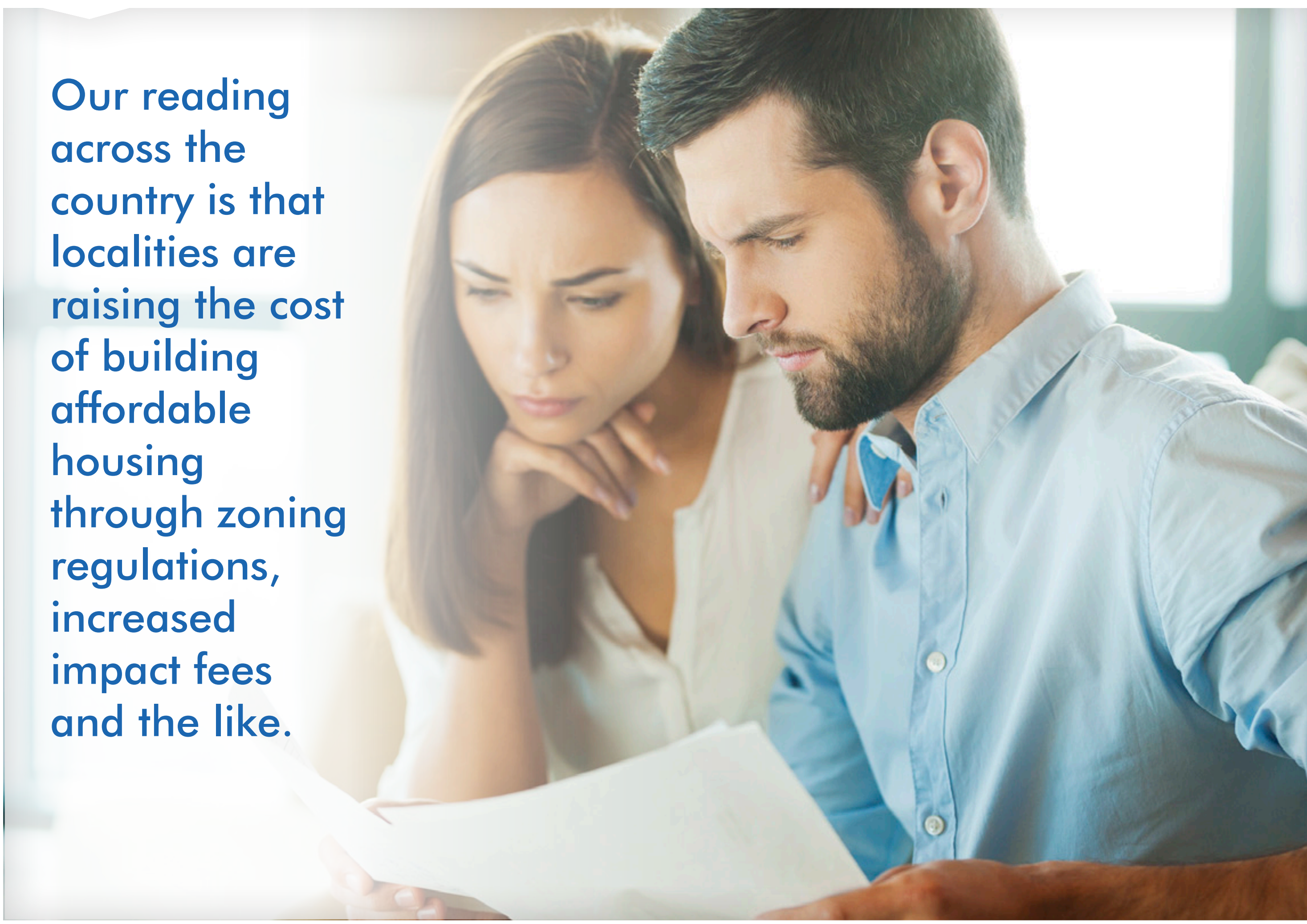
By Steve Murray, publisher

As seen in excerpts from a report by Chris Porter, chief demographer of John Burns Consulting (read it on page 18), the number of workers in the country is beginning a slowdown that will last for some years ahead. As other reports have documented, the percentage of working-age Americans with full-time employment is at a 40-year low. From recent reports, we also know that the homeownership rate has fallen to a new 50-year low as of last month.

Who's to Blame?

While most housing economists lay the blame for the decline in homeownership on banks having tightened mortgage underwriting standards, most forget to mention that the Federal government installed the Qualified Mortgage standards which require banks to tighten underwriting standards. It's also the Federal government that has underwritten or insured over a trillion dollars in student loans that crimp the ability of young people to get a mortgage, not to mention saddled them with debt that entry-level job incomes can't support. If one assumes that a lower homeownership rate is a real problem, then removing obstacles to getting a mortgage and for builders to affordably build entry-level housing would seem to be a priority. Ironically, our reading across the country is that localities are raising the cost of building affordable housing through zoning regulations, increased impact fees and the like.

With fewer workers in the future, it's possible that the homeownership rate will decline further.



TRADITIONAL WORKING AGE

LABOR FORCE SHORTAGE AHEAD

A surge in retirees (people turning 65) will slow the growth of workers in the United States.

By Chris Porter, chief demographer, John Burns Consulting

In 2000, 2 million people turned 65; 3.5 million did in 2016, and 4 million will in 2021. Even with a higher than usual rate of retiree-aged people working, U.S. economic growth will almost certainly remain slow. John Burns Consulting calculated that employment can only grow a maximum of 1.5% to 1.7% for the next three years (2.3 to 2.5 million jobs per year). After that, it will grow 0.9% to 1 % per year (1.5 to 1.6 million jobs) through 2025, even using aggressive assumptions. We believe actual employment growth will be much slower.

Slow Growth in the Labor Pool

We looked at the traditional working age population of 20–64 (the labor pool). From the time the first baby boomer turned 20 in the mid-1960s until they turned 65 in 2011, this labor pool grew at a rate of 1% to 2% per year. The reason? A much larger number of 20-year-olds were consistently entering the labor pool than 65-year-olds leaving it.

We also looked at older workers and the recent increase in their propensity to work. Even with a surge in people working past 65, labor pool growth will be slow.

We believe actual employment growth will be much lower because we made some very aggressive assumptions to calculate this paltry level of economic growth, including:

- **Very low unemployment.** The overall unemployment rate falls to 4% in 2018 and to 3.7% for those aged 20–64 and stays there through 2025. Only once in the last 30 years has unemployment averaged 4% for an entire year: the year 2000.
- **A huge return in the desire to work.** The percentage of the 20 to 64-year-old population who want to work returns to 79% in 2025—3% higher than today and the highest since the year 2000. The maximum was 80% in 1997. This would mark a significant reversal in trend for a rate that has trended down for 18 years.
- **Older people are working long.** Retiree participation continues to accelerate from today's all-time high of 32% to 37% in 2025 for 65 to 69 year-olds and from 19% today to 22% for 70 to 74 year-olds.

As we addressed in an earlier newsletter, the tightening of the labor supply will likely mean incomes will grow again, as employers have to compete for talent. New productivity tools will enable companies to do more with fewer people, but we believe wage pressure will exist nonetheless.

The expected surge in retirement will impact so many aspects of our economy that we have devoted an entire chapter to this topic in the upcoming book *Big Shifts Ahead: Demographic Clarity for Businesses.*

NEW STUDY

SHIFTING DYNAMICS OF THE HOUSING MARKET

Is the shift from owning to renting a result of changing preferences or new financial realities?

By Susan Wachter and Arthur Acolin

The U.S. homeownership rate is now at 63.7 percent, a 48-year low. Since 2006, 8 million more households rent, while the number of households who own has declined by 674,000. While much of the economy has rebounded from the Great Recession of 2009, seven years later, homeownership has stalled. Except for the Great Depression, this persistent and large decline in the number of owner households is unprecedented. Why has this occurred? What is driving the economy of renting?

Homeownership rates have decreased for all household age groups. Declines have been particularly pronounced among the young, with homeownership declining from 55 to 45 percent among households age 25 to 39.

People Still Aspire to be Homeowners

A key question is whether the shift towards renting across most age groups is the result of changing preferences. Or are new hard financial realities driving the declines?

Our research suggests that the latter is true. In fact, households continue to aspire to become homeowners today much as they have in the past. According to recent survey data, (NAR 2015), 83 percent of renters express a desire to own. And, a full 94 percent of young renters (age 34 or younger) desire to be homeowners.

While becoming homeowners may be optimal for these households, the financial barriers to doing so are increasing. Post-crisis, major banks have pulled back from lending for mortgages through government programs by imposing their own more stringent requirements. As a result, the actual ability to access lending has declined relative to historical standards despite the fact that mortgage lending rates are at all-time lows and affordability, using traditional measures, is seemingly high.

Many households are renting out of financial necessity rather than by choice. In newly published work, we show the impact of post-crisis borrowing constraints on current homeownership rates. A large body of research demonstrates the important role of lending constraints on changes in homeownership outcomes over time. Our research tests for the impact of these changes on today's homeownership outcomes.

Over the years 2009 to 2014, 5.2 million more mortgage loans would have been made if credit standards were at levels similar to those in 2001 (before the credit boom). In our work, we quantify how much of the decline in homeownership directly relates to this tightening of credit standards. We find that the homeownership rate in 2010-2013 is predicted to be 2.3 percentage points lower today than if the constraints were set at the 2001 level. Put in another way, the national homeownership rate, today, as noted above, at, 63.7%, would be 2.3% higher if constraints were at 2001 rather than 2010-13 levels. In the absence of these new constraints, the homeownership rate would be at historical post-WW II levels.

Because the demographic groups most subject to borrowing constraints are increasing as a share of the population, we find that, if lending conditions persist, their impact on the aggregate homeownership rate will likely increase over time. Moreover, over the longer run, additional economic factors may push homeownership rates lower. In particular, revitalizing cities and population gains in high priced and high job growth metros are increasing housing prices in these areas. Scenarios that include the possible combined effects of financial constraints, rising housing costs and demographic shifts show declines in aggregate homeownership rates of 10%.

The cause of the homeownership declines matters as much as the fact that they are occurring. If it is financial constraints rather than preferences that are yielding the homeownership outcomes we observe, then the advantages of being able to choose ownership are precluded for some. Revitalizing cities and increased urban amenities are generally viewed as good outcomes and, for owners, they are good: owners can stay and benefit from the appreciation of their homes in these settings. Renters, however, face higher rents and resulting shelter instability. The potential social consequences of this instability point to the new importance of attention to causes of the current decline in homeownership and the reconsideration of mitigating policies toward the goal of sustainable homeownership and affordable housing for the long run.

For more information, **CLICK HERE** to read the full brief available on Penn IUR's website.

Arthur Acolin is a Ph.D. candidate at the University of Southern California Price School of Public Policy and Susan Wachter is Co-Director of Penn IUR, Sussman Professor of Real Estate and Professor of Finance at the Wharton School.

VALUATIONS, MERGERS AND ACQUISITIONS

MANAGING BY THE NUMBERS

Know your metrics to plan for a successful future.

by Steve Murray, publisher

In our 30 years of consulting with residential brokerages on valuations, mergers, acquisitions and company assessments, we've accumulated a significant amount of data about the performance of these firms. We can track changes in agent recruitment and productivity, revenues and expenses per transaction and agent across many different brands and models and can look at these changes versus changes in the markets in general.

Over the last few years, we added a feature to our valuations that shows our clients how they stack up in key metrics against firms within their region. It's become a useful yardstick for our clients to know where they are above or below the regional norms in gross and net margin, or employment, advertising or occupancy expense. We've also produced presentations using this aggregated data that show how various brands and business models have performed over 5-10-15 years.

Do You Review Your Key Metrics?

What we find interesting is that the majority of brokerage firms don't know or don't review their key metrics when making business decisions for their firms. Is their firm growing its agent count above or below the changes in their market? Is their average commission rate declining or rising? Are their agents more or less productive than their peers? It seems that knowing at least some of these key performance metrics would be helpful in knowing how to plan for the future—where and how to invest.

Using the Metrics

One firm that does use these metrics is Keller Williams Realty International. When we do valuations for their firm, we note that most every piece of data a brokerage would want to know is in their daily/weekly/monthly reports. Starting with recruiting appointments, all the way through to listings taken and sales closed per agent per month. This data clearly plays a large role in where they invest their time and efforts. Some would say they are fanatical about recruiting, and that would be truer than not. But, their data tells them that, over a long period, the health of their business depends on successfully recruiting. Given that they just reported a quarter where they grew by over 6,000 net new agents, one can't dismiss their approach to their business.

What Should You Measure?

We firmly believe that relationships drive the success of sales associates and broker-owners. However, it doesn't mean that measuring key metrics in your business can be avoided. This is especially true when markets flatten out (which appears to be happening) and competition intensifies.

Here's what you should be measuring:

- How well are you doing regarding agent recruiting and retention against the market?
- How well are you doing regarding agent productivity against the market?
- Average sales price versus market, up or down
- Inside are your gross margins rising or falling? Why?
- Operating margins on brokerage, what are trends and why is it happening? Is it decline in gross margins or are expenses rising faster than revenue?

Do that and you'll be prepared for the future, no matter what the market.

DIGITAL MARKETING

APPROACH TECH TRENDS WITH A MARKETING MINDSET

By Paul Salley, manager of marketing and business development

As technology trends change and new platforms emerge, there's a constant adoption of and migration to different tech platforms. This holds true in every facet of technology, from operating systems to social media platforms. Digital marketing is no exception to the continually accelerated progress of technology.

There are developments and updates to proven digital marketing platforms that make their capabilities more sophisticated and easier to gauge their success. There's also the emergence of new platforms. You must be tuned in to these new platforms and understand which audiences they are attracting and leverage them accordingly. For example, Snapchat, being a newer social media platform, pulls a different user demographic than Facebook and can be a potent tool in reaching Millennials as they enter the market. Understanding how Snapchat works is critical in leveraging its capabilities regarding digital marketing. Users can add filters to their pictures, and those filters are synced to their geographic location. These filters can be sponsored. Some proactive brokerages are already sponsoring filters based on geographic location by promoting the lifestyle of the specific location. This is an inexpensive, forward-thinking method to tap into a new client base without any competition saturating the space.

Approaching current technology trends and updates with a marketing mindset will allow your brokerage to stay relevant and in front of the competition with your digital marketing campaigns. For additional information on how to get started in digital marketing, or how to optimize your current campaigns, contact tech@realtrends.com.

A SIGN OF THE TIMES

THE IMPORTANCE OF ADAPTING TO THE FUTURE OF OUR INDUSTRY

By Travis Saxton, vice president of technology

REAL Trends recently attended the Better Homes and Gardens Real Estate event in Des Moines, Iowa, which was hosted, in part, by Meredith Corporation. We heard from Steve Lacy, CEO of Meredith along with Richard Smith, who shared the vision for the brand and the future of real estate.

In 2016, after eight years of consistent growth, the brand decided to change one of its core values. Previously, their core values were PAIGE which stood for *Passion, Authenticity, Innovation, Growth and Excellence*. Now, they have changed *Innovation to Inclusion*. Why, after eight years, change something so ingrained in their business.

Let's take a deeper look at how this all started. *Better Homes and Gardens* magazine started as a farming publication that was sold door-to-door. Naturally, the sales folks rarely encountered the man of the house at the time as they were farming. So, they needed to include and engage the significant other. Thus, in 1902, the magazine was retooled into today's Better Homes and Gardens. For the next 114 years, they've continually adapted and included other demographics with publications such as Ser Padres, Espera and more.

With Hispanic consumers, LGBT, Asian buyers and Millennials, the brand realized and took a PAIGE (pun intended!) from Meredith Corp.'s book and made the change. *Inclusion* is much more than selling homes to different demographics; it's a global strategy that is the core of BHGRE. These fast-growing segments are accounting for nearly 50 percent of all real estate growth in the United States and is projected to be closer to 64 percent by 2020. They are on to something.

When asked why they removed *Innovation*, we thought the answer was spot on. While Sherry Chris is the key driver of this strategy, Steve Lacy and Richard Smith addressed this, as well. Innovation is all around us. You can't go to the grocery store and not see examples of innovation. Even tech companies aren't just tech companies anymore. Take Facebook—the brand they've built on the backbone of their technology is amazing, but in reality, they are an advertising company that happens to play in the tech industry. They will continue to innovate, and be mindful of their new core values.

Now, don't run off and change your core values. Instead, adapt to the times. Study your market, the trends, the consumer personas entering it and make changes accordingly. How is technology impacting these consumers, and how are you adapting to it? Forget status quo. With threats all around us, we need to be mindful, innovative and inclusive.

COMMEMORATIVE MAGAZINE

CHEERS TO 30 YEARS OF REAL TRENDS

Happy birthday to us! REAL Trends is 30 years old and during this year's Gathering of Eagles, April 26-28 2017, we'll be celebrating! As a part of that celebration, we're producing a 30-year commemorative magazine on the events, lives and stories of the last 30 years.

For this publication, we need your help! Please send us (rchapla@realtrends.com) your stories and photos of the leaders of your company over the last 30 years. The older the photos; the funnier the stories, so be creative!

We will publish and release this special 30-year commemorative issue at the Gathering of Eagles. It would be wonderful to have you with us.

To register, go to www.rtgoe.com. Questions? Email Dani Stufft at dstufft@realtrends.com.

CELEBRATING REAL TRENDS 30TH ANNIVERSARY

SEPTEMBER 1987: VACATION PROPERTY NETWORK AND THE SUPERMARKET FOR FINANCIAL SERVICES

To celebrate REAL Trends' 30th anniversary year, we will bring back old articles from our early years to see how much (or little) has changed about the industry.

By Steve Murray, publisher

It's amazing how some saw it coming. In September 1987, Paul Hagstrom, Jr. founded The Vacation Property Network, which proposed aggregating listing data from 32 markets in the upper Midwest United States. He made the data available to the public as well as to real estate professionals. This was like an early precursor to VacationRentalsbyOwner (VRBO), only it was 30 years ago—before the age of the Internet. Unreal, right? He also announced plans to expand his network to include resort markets in Florida and New England. Who said tech guys were the only ones to see the utility of bringing housing data direct to consumers?

REAL Trends also wrote about the Sears Financial Network with Coldwell Banker, Allstate, Dean Witter and the Discover Card bringing one supermarket for financial services. While Sears dismantled this strategy a few years after the announcement and doesn't own any of these companies today, the strategy of offering one-stop shopping to housing consumers continues. Today's largest brokerage firms, such as Realogy, HomeServices of America and numerous privately held firms, such as Long and Foster, Howard Hanna, Weichert and Real Estate One, offer mortgage, title insurance, property casualty insurance all from one platform. And, these firms are getting better than ever at cross selling.

It seems like some great ideas just take more time before a fad becomes a trend becomes an established way to do business.