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ASSOCIATION OF REALTORS®

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CONTENTS

TRENDS COME TO FRUITION

Future trends shared at the Gathering of Eagles over 10 years ago are now business as usual.

By Steve Murray, president

Many years ago, we had the pleasure of having Rich Barton, then and now CEO of Zillow, and Channing Dawson, co-founder of HGTV, present to our guests at the Gathering of Eagles. We thought so much of what they shared, that we had them back two years later.

Among the many insights, Barton shared was that "information wants to be free to all, accessible and available." He said that those who attempt to stand in the way of this trend were fated to be left behind. He didn't share this with arrogance but rather with a sense of inevitability.

Dawson shared two key points that, on the one hand, left everyone scratching their heads and on the other, laughing about their own experiences.

In the first instance, he said there was an entirely new world headed our way. He said that there would be a new universe where people lived, worked, shared, and commented—where people's attention would be drawn beyond anything we had seen before.

He shared that one such firm, Facebook, was one to watch but that it could be them or others—or multiple others.

Dawson also shared that, while it was important that brokerage firms should have young marketing and technology talent around them to interpret these new trends, it was just as important that someone with gray hair also be in the loop—to keep an eye on the youngsters.

I also recall that at a dinner with Rich and Channing with five brokerage CEOs, it was clear that while Rich and Channing felt strongly about what was coming, those of us with longtime ties to brokerage didn't fully understand its implications. We're starting to now.

THE AGE OF THE INTELLIGENT BROKERAGE AND AGENT

We had the opportunity this spring to hear about the plans of each of the largest national real estate organizations as to their current and future technology and data investments and plans. In some cases, we reviewed the presentation of what was already built and what will be coming. We've also looked into non-brokerage firms, such as Zillow and Realtor.com, Lone Wolf and CoreLogic and the direction of their technology and data developments both from public statements, deployed services and personal interviews.

IMAGINE ANY QUESTIONS

a brokerage or agent could ask, and we are entering a time where the convergence of data and AI can search and find answers. These systems tend to get better and smarter the more they are in use.

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OUR VIEW

Call it the age of the intelligent brokerage and the knowledgeable agent. As with *Moneyball*, how big data and the application of intelligence arising from the data, changed sports at all levels forever.

Systems will combine not only listing and sales data, but community data into one platform—one aggregated site. This includes all closing and tax data; social media interaction, whether through actual social sites or through other internet searches—and not just about housing; real estate education sources, demographic data about households, spending patterns, and habits and how those relate to other data, such as equity in a home; other societal and demographic data, such as age of children, vacation plans etc., and hundreds of other data points; and information collected and from such devices as Siri, Alexa and Google Home.

Now, apply artificial intelligence (AI), or learning systems that access all of this data to discern patterns of consumer behavior as to housing, mortgage finance, investment decisions, etc. Imagine the questions one might ask such a system and the answers it could derive.

- Who are my best candidates for purchase or sale in the next three, six and 12 months? (An easy one)
- What are the pricing patterns expected in the next 12, 24 and 36 months in the neighborhoods where my clients live?
- Which agents on my roster are most likely to increase their business over the next 12 months based on what their database looks like, how they're connected to those clients and customers (based on the frequency of interactions), and what the potential turnover looks like in that database? What does this mean for potential income for the agent and the firm?
- Who are the agents who might fit best with my brokerage? What is the profile of new people taking the real estate test and getting a real estate license, and how do I focus on those who fit best with my firm?
- Based on the database of clients and customers, and the retention of data from internet searches, what does the next year look like for our agents and our firm?
- What are the most effective ways to add to our databases of clients and the best ways to reach and stay in touch with them?
- What messaging is most useful to reach sellers? Or buyers?

Imagine any questions a brokerage or agent could ask, and we are entering a time where the convergence of data and AI can search and find answers. These systems tend to get better and smarter the more they are in use.

Is it three years, five years or more before this all becomes a reality?

HUMANS ARE THE VALUE WEDGE!

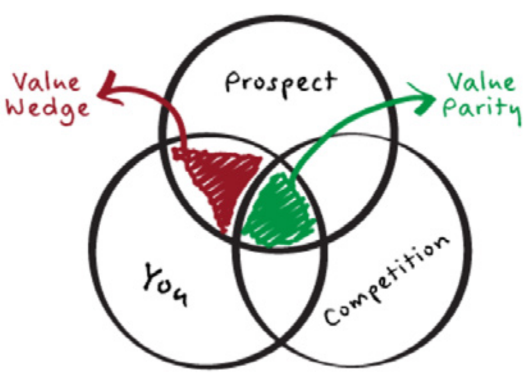
Your brokerage's unique personality and knowledge are what give you the edge.

By Larry Kendall, author of Ninja Selling & chairman emeritus of The Group, Inc. Real Estate

Have you observed that money flows to value? Our value proposition typically answers three basic questions:

1. How do I solve a client's problem? (pain)
2. How do I make them feel good? (pleasure)
3. How am I different from competitors? (value wedge)

The third question involves our *value wedge*, as shown in the diagram below.



Value Parity is what nearly all sales associates and companies provide, including competitors. Examples for a seller include a yard sign, multiple listing service (MLS), and home brochure. Nearly everyone offers these services, so they are not differentiating. The seller wants to know what we do that is different and valuable. This is the Value Wedge.

What is the most significant component of the value wedge? In my observation, it is the human factor—the unique personality, caring, knowledge, rapport, and skills of the person delivering the service. Take the human element out, and you come close to having a commodity. Commodities have a reduced value.

ARE WE IMPROVING SERVICE?

In our efforts to improve technology, are we enhancing our service or commoditizing it? Here's an example from the mortgage industry. After five days with 116 top-producing mortgage loan officers, they all agreed on one thing: Their companies' efforts to improve technology had commoditized certain parts of their business, making it harder for them to build relationships, counsel borrowers, and create a value wedge.

Buyers jump on the various prequalification apps to find the best rate. What buyers need is to *find the best loan* for their situation. This comes with counseling. For example, if the buyers have limited cash, the best loan for them may be one that takes less cash but has a slightly higher rate. The opportunity for the loan officer to counsel the borrower to find the best loan may never happen.

In many cases, the value wedge and the human factor are being eliminated in the prequalification process. By the time the loan officer sees the computerized prequal and follows up on it, the buyers are confused. Has this process improved the borrower's experience? According to the loan officers, it has increased confusion and lowered conversion rates from prequal to application.

What about the real estate brokerage industry? Will the current tech race and infatuation with ibuyers commoditize the brokerage transaction? Is technology making it better for consumers? Is this effort consumer driven or industry driven? Where should you place your bets?

Jeff Colvin, in his book, *Humans Are Underrated, What High Achievers Know that Brilliant Machines Never Will*, says the soft skills of Empathy, Creativity, Communication, Collaboration, and Relationship are the critical 21st Century Skills. He believes the human factor will be more critical than ever. Humans are the value wedge.

2019 REAL TRENDS GATHERING OF EAGLES

RELATIONSHIPS (NOT TECHNOLOGY) MATTER MOST

Missed the event of the year? No worries, we've got the top takeaways from the conference ready for you.

By Tracey C. Velt, editor

This year's Gathering of Eagles brought together leaders from all models of real estate brokerages to hear from industry icons, technology gurus, advertising experts and more. Missed the event? No worries, we cherry-picked the most pertinent tips and quotes from the event. The overarching theme: Technology only serves to help agents facilitate relationships. While the focus has been on technology, the truth is success in real estate has always been—and will always be—all about the relationships.

1. **FACEBOOK HAS THE POWER.** Well, not really, but Ken Auletta, keynote speaker and author of the book, *Frenemies,* regaled GOE attendees with an insider view of the advertising world. Included in that analysis was the fact that social media is manipulating your decision to take action, buy something or sign up for a service. Of course, we all know that, but we're still getting sucked in. Something to think about when you're developing your next Facebook ad: no one likes being manipulated, so consider transparency and reaching out instead of gimmick ads.

2. **ONE-STOP SHOPS ARE THE FUTURE.** Robert Reffkin of Compass talked about making his company the "Amazon of real estate." He thinks that along with the already-in-place Compass Concierge, which allows his agents to be full-service advisors, along with mortgage, title, and insurance components will offer the perfect way to fight the culture of the discounters. He also announced that listing agents always get the lead, even if they're not with Compass. "On the Compass website, if you're the listing agent, you get the lead, no matter what. It creates transparency, and creates the foundation for various ways to partner," he says.

3. **IF YOU CAN'T BEAT THEM; JOIN THEM.** The GOE iBuyer panel (by the way, they hate the term iBuyer), wants to make the transaction more straightforward for the home seller, so you have something in common with them. One tip: During your listing presentation, give prospective sellers all of their options, so you don't get left out of the transaction.

4. **TECH IS GREAT. BUT...** Sure, Keller Williams is rebranding itself as a technology company, but their leaders are smart enough to know that technology is about making the transaction more efficient for the buyers and sellers. It won't take the place of great relationships. Coach Tom Ferry posed the thought that "Agents don't care about technology. They care about whether their kid is smoking pot, how they're going to lose weight, and when they'll get their next listings." In response, Keller Williams CEO Josh Team said, "I agree they don't care about disruption on a macro level, but when it hits their bottom line, they care a whole lot. Agents do care about technology because to stay relevant, they need to compete with disruption." Ferry also mentioned that brokers should not give their managers an office. "Managers should be out on the floor getting to know the agents."

5. **GO BACK TO BASICS.** Ninja Selling's Founder Larry Kendall discussed the relationship-building basics that brokers and agents should get back to ASAP. "Focus on productive activities, and the sales will take care of themselves. We call these activities FLOW. Have your sales associates keep a weekly log of their flow activities (handwritten notes, live interviews, real estate reviews, mailings, etc.) If they are in a slump, your first question is, "Can I see your activity log?" Sure enough, you will notice a drop off in their activities about 45 to 90 days before their production slump. Activities predict production. Do a pattern interrupt! Get them back into the flow again and logging their activities.

6. **IT'S TIME TO TELL YOUR STORY.** Author and coach Mike Staver says to increase productivity, you have to reduce the noise (internal and external). To retain agents, he says you must be willing to tell your story. "Telling people why you'll go to battle to get them over the hill will do more for you than promising them money. Most agents will tell you it's not about the money. The higher the percentage of people who leave you for the money; the more likely you will resign yourself that you can't compete against money," he says. So, get good at getting to know your agents and telling your story.

"TELLING PEOPLE WHY you'll go to battle to get them over the hill will do more for you than promising them money."
– Mike Staver

APRIL SHOWINGS ARE SLUGGISH

Market Sees Ninth Straight Month of Diminished Year-Over-Year Activity

KEY POINTS:

- April saw a 6.5 percent year-over-year decrease in showing activity across the U.S. despite a drop in mortgage rates; the West Region, down 11.1 percent, again recorded the largest year-over-year decline of all four regions
- For the seventh consecutive month, showing activity also fell in the South (-8.1 percent), the Midwest (-7.1 percent) and the Northeast (-3.8 percent)

Real estate agents throughout the U.S. may have to brace for a more sluggish market than anticipated based on last month's decline in home showing activity, the ninth consecutive month of a nationwide year-over-year decrease according to the ShowingTime Showing Index®.

Buyer traffic was down 6.5 percent across the U.S. compared to the same time last year. The diminished showing activity was felt in every region throughout the country, most notably in the West, where for the 13th consecutive month showings declined on a year over year basis.

"Showing activity stabilized and is holding steady, but it is still slightly off from the higher levels registered in 2018," said ShowingTime Chief Analytics Officer Daniil Cherkasskiy. "The slowdown in showing traffic continues to be concentrated in the upper price quartiles across the U.S., with less expensive homes registering the same or slightly higher levels of showing traffic than at the same time last year."

> "**SHOWING ACTIVITY STABILIZED** and is holding steady, but it is still slightly off from the higher levels registered in 2018. The slowdown in showing traffic continues to be concentrated in the upper price quartiles across the U.S., with less expensive homes registering the same or slightly higher levels of showing traffic than at the same time last year."
>
> **— Daniil Cherkasskiy, ShowingTime Chief Analytics Officer**

ShowingTime® Showing Index April 2019

UNITED STATES	WEST REGION	MIDWEST REGION	SOUTH REGION	NORTHEAST REGION
-6.5%	-11.1%	-7.1%	-8.1%	-3.8%

The ShowingTime Showing Index tracks the average number of buyer showings on active residential properties on a monthly basis, a highly reliable indicator of current and future demand trends.

Methodology: The ShowingTime Showing Index® measures showing traffic per residential property for sale by agents and brokers utilizing ShowingTime solutions for property-access management. A higher number means that an average home receives more buyer visits in a given month. All index values are scaled relative to initial index value set to 100 for January 2014. ShowingTime facilitates more than 4 million showings each month.

The ShowingTime Showing Index, the first of its kind in the residential real estate industry, is compiled using data from property showings scheduled across the country on listings using ShowingTime products and services, providing a benchmark to track buyer demand. ShowingTime facilitates more than four million showings each month.

Released monthly, the Showing Index tracks the average number of appointments received on active listings during the month. Local MLS indices are also available for select markets and are distributed to MLS and association leadership.

To view the full report, visit **www.showingtime.com/index.**

ABOUT SHOWINGTIME

ShowingTime is the residential real estate industry's leading showing management and market stats technology provider, with more than 1.2 million active listings subscribed to its services. Its showing products and services simplify the appointment scheduling process for real estate professionals, buyers and sellers, resulting in more showings, more feedback and more efficient sales. Its MarketStats division provides interactive tools and easy-to-read market reports for MLSs, associations, brokers and other real estate companies, as well as a recruiting tool for brokers. ShowingTime products are used in more than 250 MLSs representing nearly one million real estate professionals across the U.S. and Canada. For more information, contact us at research@showingtime.com.

IT'S A NEW CFPB

Public statements and actions by Director Kathy Kraninger shed some light on her approach to financial services regulation and enforcement.

By Sue Johnson, strategic alliance consultant

The Senate confirmed Kathy Kraninger as Consumer Financial Protection Bureau (CFPB) Director in December 2018, following a year-long stint by Mick Mulvaney as Acting Director. Given her lack of a financial services background, no one was certain about the path Kraninger would follow when she assumed the helm. But her public statements and actions over the last few months have shed some light on her approach to financial services regulation and enforcement.

NO MORE RULEMAKING THROUGH ENFORCEMENT

Former Director Richard Cordray's tenure was defined by the CFPB's failure to provide clear guidance as to what was expected to avoid legal action under federal consumer protection statutes such as the Real Estate Settlement Procedures Act (RESPA). The most glaring examples of this policy were his administrative ruling against PHH, in which he ignored previous HUD guidelines to set new RESPA standards (which later was vacated by the D.C. Court of Appeals), and the CFPB's consent orders on marketing services agreements (MSAs) that created confusion throughout the industry by vaguely warning against the usage of MSAs without further guidance.

Mulvaney signaled during his tenure that this era of "regulation by enforcement" at the CFPB was over, and Kraninger also appears to have adopted this policy. In an April 17 speech, she announced that the CFPB will no longer engage in rulemaking through enforcement and instead will use formal rulemaking that provides "clear rules of the road. Rules "are not best articulated on a case-by-case basis through enforcement actions," she said.

MORE TARGETED CIVIL INVESTIGATIVE DEMANDS

On April 23, the CFPB announced that its Civil Investigative Demands (CIDs) would provide more information about the potentially wrongful conduct under investigation. Under Cordray's tenure, CIDs had been worded in extremely broad terms, leaving the recipient with little information as to what specific conduct may have violated the law and inviting what some called fishing expeditions under which the Bureau would request a wide array of information and then change the scope of the investigation based on what it learned from the acquired materials.

A REVAMPED NO-ACTION LETTER PROGRAM

The CFPB's new Office of Innovation (created by Mulvaney) is overhauling the Bureau's 2016 No-Action Letter Program, which provides limited enforcement relief to companies that develop "consumer-friendly innovations" for "emerging products or services" when regulatory standards are uncertain. In a December 13, 2018, Proposed Rule, the CFPB noted that

> Former Director Richard Cordray's tenure was defined by the CFPB's **FAILURE TO PROVIDE CLEAR GUIDANCE** as to what was expected to avoid legal action under federal consumer protection statutes such as RESPA.

there has only been one No-Action Letter issued so far, indicating that the Program has not provided firms with sufficient relief to encourage applications. It requested public comment on ideas to improve and expand the Program, such as a streamlined application process, confidentiality safeguards, and agreements with state regulators for similar state relief. In the same proposal, it outlined a new Product Sandbox Program that would give companies additional regulatory relief when testing new financial products and services.

POSSIBLE TRID CLARIFICATIONS IN THE WORKS

Kraninger has recognized publicly that additional changes may need to be made to the Truth in Lending Act-RESPA Integrated Disclosure (TRID) rule. In a January 14 response to a letter from Senator Hoeven (R-ND) expressing concern that the TRID rule does not allow title companies to disclose available discounts on mortgage disclosure forms, Kraninger replied that the CFPB intends to launch a mandatory five-year assessment of the TRID rule and will "carefully examine" the disclosure of title fees during that assessment. She informed Congressman Brad Sherman (D-CA) during an April House committee hearing that she has heard about needed clarifications to TRID from stakeholders and said that it "is something we are looking at."

LITTLE FOCUS ON MSAS AND AFFILIATED BUSINESSES…SO FAR

Kraninger has demonstrated less awareness of issues raised by Cordray's controversial interpretations of Section 8 of RESPA, although she has expressed a willingness to review concerns brought to her attention. She indicated that she was not aware of a 2015 RESPA bulletin that Congressman Sherman told her at an April committee hearing was "problematic" (presumably referring to the CFPB's vaguely-worded 2015 compliance bulletin on MSAs), but stated she "will go back and take a look at it." When Congressman Bill Huizenga (R-MI) asked if the CFPB will change the definition of "points and fees" in the Qualified Mortgage rule to correct the disparate treatment of affiliated title fees, she acknowledged that the CFPB has been asked to reconsider the "points and fees" definition and that she "has been talking with staff extensively about the issue."

In April testimony before the Senate, Kraninger emphasized that she is committed to enforcement and will "take aggressive action against bad actors who break the rules by engaging in fraud and other illegal activity." But based on her recent remarks and actions, the industry also can expect more guidance and collaboration from the CFPB over her five-year term.

Sue Johnson is the former executive director of RESPRO, the Real Estate Services Providers Council Inc. She retired in 2015 and is now a strategic alliance consultant.

> [Kraninger] announced that the CFPB will no longer engage in rulemaking through enforcement and instead will use formal **RULEMAKING THAT PROVIDES "CLEAR RULES OF THE ROAD."** Rules "are not best articulated on a case-by-case basis through enforcement actions," she said.

GLOBAL RESIDENTIAL REAL ESTATE

HOTSPOTS AROUND THE WORLD

By Peter Gilmour, chief foreign correspondent

Transportation and new developments drive global hotspots.

Global residential hotspots continue to emerge, ranging from new technology centers to areas of significant new developments and those transformed by new, faster transport links.

We have seen many of these areas in North America. Delray Beach, Florida, situated close to two airports and recently serviced by the new $1 billion Brightline train, is a good example. Detached family homes around 3,500 square feet with a pool start at around $3 million with similar-sized townhouses starting at $2 million. Boston's Seaport District, near the Financial District, is popular with young professionals and older residents alike. With over 11,000 residents, the area is well serviced by cinemas, restaurants, and bars. Two-bedroom apartments start at about $1,800 per square foot with developments commanding the best views close around $3,000 per square foot. Knight Frank, in its 2019 Wealth Report, has also identified several global hotspots—areas that are predicted to outperform the rest this year.

Luca, Italy

LUCCA, ITALY

Lucca, Italy is a scenic, walled city in Tuscany. The historic center is comprised of cobbled streets, shaded piazzas, art galleries, restaurants and many churches situated within the old city walls. Lucca offers a great lifestyle and sense of community close to the town of Pisa and the Mediterranean coast. It provides an alternative to the more tourist-filled areas, and a renovated three-bedroom apartment starts at $900,000 with larger apartments starting at $1.6 million.

Brisbane, Australia

BRISBANE, CANBERRA, AUSTRALIA

Cities of Brisbane, Canberra, and the Gold Coast are showing reasonable growth in prices as Sydney investors look elsewhere for better returns. Sydney and Melbourne's markets are still expected to weaken further in 2019 with tightening lending criteria and the abolition of negative gearing on resale properties should the government change in the federal elections to be held in May 2019. Negative gearing is an Australian tradition and investors hope to secure negative gearing arrangements ahead of the election as all existing negative gearing arrangements at the time of the election will not be affected.

KOWLOON, HONG KONG

Kowloon in Hong Kong is in the Hung Hom area situated close to the exit of The Cross Harbour tunnel from Hong Kong Island. The city has traditionally been home to blue- and white-collared workers, but now has a large, new metro station to add to the road and ferry links to Hong Kong Island. The impact of the massive rail link is being felt in the nearby real estate with prices rising steadily. Two- and three-bedroom apartments are now priced between $2,300 and $2,500 per square foot. Hung Hom is also an area of delicious, authentic Chinese food.

Kowloon, Hong Kong

GENEVA, SWITZERLAND

Another hotspot that Knight Frank lists in Geneva, Switzerland, a sophisticated lake city. Steady development and price growth are happening in the Trois Chênes area, east of the city, which has been transformed into a new transport hub. A new rail link with the French Alps will provide fast connections to Evian and other cities in France as well to the Geneva Airport. Freehold two-bedroom apartments in Trois Chênes start at $900,000 while four-bedroom homes are selling for $1.6 million and upwards. Other hotspots in the Knight Frank report include the Wynyard Quarter, Auckland; Chelsea, London; St. Kilda Road Precinct, Melbourne; Applecross, Perth and the Pasadena area of Los Angeles, California. These areas are all demonstrating strong price appreciation and are likely to attract savvy home buyers and investors in 2019.

Leman Lake, Geneva, Switzerland

BROKERAGE VALUATION

WHAT'S IMPACTING THE VALUE OF YOUR FIRM?

Key factors to consider when evaluating the value of your brokerages. | By Steve Murray, president

REAL Trends performed between 200 and 250 formal valuations in the past year—about equal to the year before that, and 50 percent more than in previous years. While some of these are for the sale or purchase of a brokerage firm, just as often they may be for the purchase or sale of interests in a brokerage, divorce within families, life insurance, estate gifting, and other general purposes.

We hear from brokerage leaders often on this topic and read other sources from time to time as to what factors, other than the actual financial results, are examined when doing a valuation. Here we review a few of the more critical factors that affect the ultimate value of a brokerage firm, regardless of the reason for the valuation assignment.

LOCATION

The valuation of residential brokerage firms (and related entities such as mortgage, title insurance, escrow, and property management) is often affected by the size of the market where the client is located. Larger markets generally bring higher valuation results. This is because there are likely more purchasers or investors both inside and outside of the market that would have an interest and because the upside opportunity to grow an acquired business is higher in a larger market than one that is smaller. Many acquirers are seeking to build a scalable firm, and that is far easier in larger markets.

There are, of course, exceptions. A large, market share leading brokerage, in a smaller market, may be valued as high as a sizeable non-market share leading firm in a larger market. Again, location comes into play as that large market share leading firm in a small market still needs to have some proximity to a larger market to attain an equivalent valuation.

CORPORATE STRUCTURE

The vast majority of brokerage firms (and related entities)

are some form of a pass-through legal entity such as a partnership, an LLC, or an S corporation. A brokerage firm with this kind of structure generally will see no adjustments, positive or negative, in their valuation.

For those few that are organized as C corporations, the situation is different, and most of the time, it harms valuation. Why? Most buyers (in fact virtually all) desire to purchase the assets of a brokerage firm, and not its stock. This is for both liability and tax reasons, and it has been the case for the past 25 years at least.

However, a seller of assets in a C corporation generally faces ruinous double taxation on the proceeds from the sale of assets out of a C corporation as they first have to pay capital gains taxes on the internal gain, then pay personal taxes to extract monies from the C corporation as salary, bonus or dividends. Thus, purchasers do not want to buy shares in a brokerage, and sellers do not want to sell assets from a C corporation. The standoff results typically in the purchaser agreeing to purchase the shares of the seller (rather than the assets) but at a discount which leaves the purchaser no worse off from an after-tax point of view.

COMPATIBLE CULTURES AND COMMISSION PLANS

There is a multitude of types of residential brokerage firms today with far more diversity in commission plans and service delivery than in years past. This is neither good nor bad for the industry, but it does affect valuation.

In the past, the largest brokerage firms would be generally considered *traditional, full-service* with some form of graduated commission plans.The Gross Margins (Company Revenue) of these incumbents were usually within a specific range of each other. Competition generally kept a lid on a brokerage firm having a significantly higher Gross Margin than their chief competitors.

Today, many large firms have entirely different types of plans, many are lower cost, with less infrastructure, less managerial overhead, lower levels of office space, etc. The number and size of these kinds of firms have grown substantially over the years in many different markets.

The challenge for them is that there aren't many in each market and the larger national and regional firms that are the major investors in residential brokerage firms can't mix the plans they have in that market with such a firm. Nor are there yet large national firms with war chests to acquire such firms (although there are at least three we are aware of raising funds to do just that).

A firm with a flat monthly and transaction fee plan, with a Gross Margin of 11 percent is not going to be compatible with an acquirer with a Gross Margin of 20 percent. Our experience is that such an acquirer, although desirous of the market share that the lower Gross Margin firm may have, will look elsewhere for growth given the incompatibility between the firms.

Further, given the lack of capital (thus far) among the brokerage firms with lower Gross Margins, there is lower liquidity (and hence lower valuations) for these kinds of firms. As we comment, we do believe this is changing as several firms of this kind are raising capital to expand.

Likewise, a brokerage firm that has a measurably higher Gross Margin than the investors or purchasers in a particular market may have the same problem as the lower-cost brokerages. Where most of the purchasers in a given market have average Gross Margins of 20 percent and a seller is at

On top of all these factors, there is the market place itself. The current market for most brokerage firms is certainly more bearish than the market two years ago at this time. When housing markets are stable to increasing, then values typically move upwards. When housing markets are headed down, as they have been doing since the first quarter of 2018, then brokerage valuations are going to either be flat or in decline.

28 percent for example, the purchaser will be leery of trying to both pay for the higher Gross Margin firm and then figure out to how to keep it there when their other local operations are at 20 percent. Of course, this is not as much of a factor when the purchaser has no local operations. However, even in this case, purchasers are now wondering not only how the higher Gross Margin brokerage accomplished it, but how much longer it can be maintained in the market of 2019-2020.

In addition to compensation plan factors, other cultural factors come into play. These include the level of support service differences between two firms, the history of support for core services, branding (national branding or local brand name), office structure, per-person productivity and other such factors.

THE IMPORTANCE OF LEADERS

Among the most important cultural factors is that of the continuation of the leadership of a potential seller. Our experience has shown that this is the single most crucial factor. Most leading brokerage firms, regardless of type, location, or compensation plan, has a leader or leaders who built the company. Future success is highly predicated on the retention of these leaders. We won't belabor this point here, but the ultimate value of a brokerage firm is highly affected by the continuation of the leadership in some form.

FRANCHISE AFFILIATION

This is among the most misunderstood factors of all the non-financial factors affecting the valuation of residential brokerage firms.

Most franchise agreements restrict the ability of an affiliated firm from selling shares or a controlling interest to other parties without the permission of the franchiser. The history of the actions of franchisers is that they do not approve of such transfers or sales unless the franchised brokerage remains in the current franchise. This history goes back 35 plus years.

This limits the number of purchasers for such a firm. Logic instructs us on this point. A firm with five potential suitors versus one potential suitor is generally going to have a higher valuation.

It's true that the franchise itself has contributed to the increase in the value of a brokerage firm. We are not arguing that point. It's more likely true than not, otherwise, why would intelligent brokerage leaders agree to the franchise in the first place, absent some value they believed they were getting in the exchange?

Our experience indicates that regardless of a franchise brand, the value of a franchised brokerage does increase *in most but not all cases* as the franchise agreement nears its end. That's because that franchised brokerage is approaching the point where they may access a far broader market for their firm than that within its franchise brand.

Note that we say *in most but not all cases* because then the valuation has to take into account all of the other non-financial factors we list here together with the financial considerations.

THE HOUSING SALES MARKET

On top of all these factors, there is the marketplace itself. The current market for most brokerage firms is certainly more bearish than the market two years ago at this time. When housing markets are stable to increasing, then values typically move upwards. When housing markets are headed down, as they have been doing since the first quarter of 2018, then brokerage valuations are going to either be flat or in decline.

2019 DEALMAKERS CONFERENCE

TRENDS IN VALUATIONS AND MERGERS & ACQUISITIONS

Experts Dispense Advice at REAL Trends' DealMAKERS Conference

By Toni Lapp, senior editor

The real estate market is softening, and home sellers who were accustomed to being in a strong negotiating position are seeing their advantage slip away. As go homes sales, so go brokerage sales, said Scott Wright, vice president of REAL Trends at the DealMAKERS conference, a precursor to the annual Gathering of Eagles meeting.

In 2017, REAL Trends hosted the first DealMAKERS conference, which was designed to answer the most critical questions brokerage leaders have about how to value their companies and teams. That year, the seller's market was peaking.

What a difference two years make, said Wright, adding that some brokerages that were once candidates to sell may now be deciding to buy instead. Since valuations have come down, they may look to merge with or acquire another firm rather than try to wait for another upturn to improve their acquisition deal.

In a panel presentation called "Valuation and Deal Terms," Wright was joined by Alicia Vivian, the chief financial officer of REAL Trends, who works with Wright to determine the valuation of brokerages as part of REAL Trends' consulting work. The panel was rounded out with two executives from franchises that have been actively acquiring brokerages: Chrissy Oliver of Compass and Alex Seavall of HomeServices of America.

The most significant change for brokerage acquisitions is that the transactions are commanding less up-front cash, much to the chagrin of sellers, noted Wright. "We see an environment with margin compression at the top," said Wright. "Valuations are determined by the last 12 months of activity, which hasn't been as strong."

Brokerages, said Wright, do not get to cherry-pick their best year from several, "it's 'what have you done for me lately,'" he quipped.

The key to preparing for a potential transaction, said Vivian, is to ensure the proverbial house is in order with regards to financial statements, contracts, and agent productivity. "It makes the process much easier when you have clean and organized data available at your fingertips," she said. "Someone in the organization who can speak to the financials should be prepared to do so."

Another factor in the M&A environment is that Realogy Holdings, which had been busily acquiring brokerages, announced in January 2019 that it was going to suspend acquisitions. That's taken some pressure off buyers to act, the panelists agreed. It's worth noting that HomeServices of America recently displaced Realogy's NRT in terms of transaction sides from the REAL Trends Five Hundred ranking of brokerages, although NRT still beats HomeServices when it comes to the total dollar volume.

Jim Thomas and Barbara Wells of Minor and Wells law firm

WILL THIS HAVE ANY BEARING ON FUTURE ACQUISITIONS?

Seavall of HSA said "our formula has evolved," adding that the organization looks for brokerages with strong leadership who are demonstrating growth despite the declining market. "We believe in the local ability of management to make the best decisions," something they had "learned the hard way."

Acquisitions have helped Compass quickly grow from its launch in 2012, said Oliver, who oversees strategy and growth for the New York-based tech brokerage. Oliver noted that Compass is now focused on its 22 markets and gaining market share in those areas. She said that 2018 was an expansion year, in which the franchise opened in 11 new markets.

In a session that followed, "Legal and Tax Issues," attorneys Jim Thomas and Barbara Wells of Minor & Brown law firm discussed how the 2017 Federal Tax Act would impact the business. It's paramount to choose the most favorable corporate structure as you consider an M&A down the road, they noted, reviewing the differences between S Corporations, C Corporations, and partnerships. Acquiring stock to buy a brokerage is too risky, they said and does not confer tax advantages. It's risky because the buyer is "acquiring every skeleton in the closet," said Thomas.

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ALL NEW REAL TRENDS 2020 GATHERING OF EAGLES

WHEN REAL TRENDS FIRST STARTED THE GATHERING OF EAGLES more than 28 years ago, we were the first group to offer a cross-branded, brokerage leader, invitation-only conference. Well, imitation is the sincerest form of flattery and others are doing the same.

As an industry innovator, REAL Trends is changing things up in 2020! Headlining the event is Patrick Lencioni, founder of The Table Group and author of *The Five Dysfunctions of a Team,* and *The Advantage: Why Organizational Health Trumps Everything Else in Business.* He'll talk about how to build a healthy organization—perfect for your whole management team.

We're also opening up the event to brokerage leaders and managers, so register early, as space is limited. After Lencioni's keynote, consultants from his company will be working with small groups on implementation of his core fundamentals. It's a can't-miss event!

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