Dangers Impacting Agents

Section A | First of Five Sections

An Official Extract from the **D.A.N.G.E.R.** Report
the definitive analysis of negative game changers emerging in real estate

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Section A

DANGERS IMPACTING AGENTS

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CRITERIA, FORMAT, AND STRUCTURE OF THE STUDY

BACKGROUND

The Strategic Thinking Advisory Committee (list of Committee members appended to this Report) of the National Association of REALTORS® (NAR) was tasked with the responsibility to identify those future events or clashes, both anticipated and unexpected, that could negatively impact the real estate industry. NAR retained the services of the real estate industry's leading analyst, and *New York Times* best-selling author, and author of more than 30 books, Stefan Swanepoel.

The culmination of the research and analysis led to the creation of a 160-page study titled: *D.A.N.G.E.R. Report*. D.A.N.G.E.R. is an acronym for Definitive Analysis of the Negative Game Changers Emerging In Real Estate.

OBJECTIVE

The goal was to provide Organized Real Estate, as well as its members, a comprehensive report identifying the most significant threats, risks, and black swans facing the real estate industry without judging or discarding them, without placing blame or picking sides, and without attempting to solve them. This way the information gathered and analyzed could be of benefit to many and would hopefully empower people to have a more extensive understanding of the complexities of the industry.

SOLUTIONS

The Report seeks to identify the most significant dangers but does not provide solutions for any danger. It was decided at the beginning of the project that identifying solutions is the responsibility of each respective leader and organization. It is the strategic interpretation of each danger by leaders and how they decide to respond that provides each organization its unique competitive advantage and sets them apart from their competitors.

BENEFICIARIES

"Black swans," it is said, are unpredictable future events. Of course we do not know which black swans, if any, will occur, but with this Report identifying so many, you now have more knowledge than before. It is our wish that the *D.A.N.G.E.R. Report* will be a resource for the entire industry.

MARKETS COVERED

The initial research was focused on the residential real estate brokerage industry in the United States. Subsequent studies covering commercial real estate, property management, and the global markets outside the U.S. are being considered.

EXCLUSIONS

We acknowledge that most catastrophic type events—such an Economic Collapse, a major Natural Disaster, a Global Disease Outbreak, a significant Terrorist Attack, and/or a Nuclear Accident—would most likely trigger a chain reaction of events negatively impacting society in general, the housing market, and the real estate business. These exceptionally large and unforeseeable phenomenons have not been included in the list of dangers tabulated.

RESEARCH

The Swanepoel | T3 Team researched over 200 reports, surveys, focus group studies, student dissertations, white papers, journals, articles, and other related academic resources, including reports from Harvard, Wharton, Deloitte, KMPG, PWC, Credit Suisse, Urban Land Institute, Canadian Real Estate Association, Mortgage Bankers Association, Fannie Mae, various large real estate franchise groups, and many others.

SURVEY

To ensure that the Report would also include opinions from the brokers/agents in the field, an extensive, random survey of REALTOR® members was undertaken from October 13, 2014 to October 27, 2014 (details of the survey is appended to this Report). The survey received and incorporated 7,899 responses.

INTERVIEWS

In addition to the research and survey, 70 CEOs and other senior executives from the largest franchisors, the largest real estate brokerage companies, national, state, and local REALTOR® Associations, MLS organizations, and a variety of large service providers were interviewed. Each was asked the same open-ended questions. In order to obtain the most accurate information, the interviews were all conducted as one-on-one, face-to-face interviews by Stefan Swanepoel, with contributors included in the Report without attribution.

CRITERIA, FORMAT, AND STRUCTURE OF THE STUDY

REPORT

The results of the research and analysis are incorporated in the *D.A.N.G.E.R Report*. The research data, survey results, and interview responses were categorized into one of five major industry sections: Agents, Brokers, National Association of REALTORS®, State/Local Associations of REALTORS®, and MLS organizations.

Each danger is presented on a double page spread, beginning with its reference number (category and ranking; e.g. A1 – most severe danger in the Agent section), followed by a descriptive title, a short statement of the danger, and an "In Context" section providing clarity on the background of the danger. The final contribution to each danger is the Author's Perspective. This reflects the author's perspective and ranking of the danger's threat level on the Probability, Timing, and Impact of each danger.

PTI INDEX | DANGER INDEX

In evaluating each danger, the overall result is presented in the PTI index (Probability, Timing and Impact), which ranks the danger in order to provide a level of comparison between the dangers/sections of the report. The Danger Index represents a composite, overall score.

#	Probability	Timing	Impact	Danger Index	
5.0	100% Chance	1 Year	Game Changer	81-100	Critical
4.0	80% Chance	1 - 3 Years	Major Impact	61-80	Severe
3.0	60% Chance	3 - 5 Years	Moderate Impact	41-60	High
2.0	40% Chance	5 - 10 Years	Some Impact	21-40	Moderate
1.0	20% Chance	10 + Years	No Impact	0-20	Low

DATA CLASSIFICATION

In order to best evaluate and present each danger, an Index was created based on the probability (P) of each danger occurring, the future timing (T) of the potential danger, and the possible impact (I) of each danger. The combined scoring of these factors results in the PTI Index. The index is not scientific but rather a combined and weighted representation of the research, surveys, and interviews that enable the dangers to be placed in order of significance as to the level of danger they present.

CHECKLISTS

At the end of the Report a detailed checklist of all dangers is provided—first in priority order by section and second in overall combined priority for quick comparison. Download these checklists separately and use them for your next strategic planning or management retreat to ensure that your organization is at least aware of each of these dangers. Slide decks are also available for your personal use and can be downloaded from the websites listed.

IMPORTANT NOTE

Remember that the 50 dangers listed in the *D.A.N.G.E.R. Report* are about hypothetical future events that may or may not occur. The dangers included are a compilation of the opinions of a large group of the most knowledgeable and influential leaders in our industry.

No confidential information was included in this Report. The content does not necessarily reflect the opinion of the National Association of REALTORS®, its management or elected leaders.

As far as possible, the information gathered is provided with its original intent and messaging intact. Information may or may not apply to your market and you are always urged to use sound judgment and consult with proper counsel and experts before making any significant decisions.

DISTRIBUTION

The 160-page *D.A.N.G.E.R.* Report is distributed electronically to the real estate community at no cost. The Report will be available separately in each of the five sections as well as one combined Report and can be downloaded from one of two websites from: realtor.org/dangerreport and dangerreport.com.

A print edition will also be available from the National Association of REALTORS® bookstore.

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DANGER A1

MASSES OF MARGINAL AGENTS DESTROY REPUTATION

The real estate industry is saddled with a large number of part-time, untrained, unethical, and/or incompetent agents. This knowledge gap threatens the credibility of the industry.

IN CONTEXT

The knowledge and competency gap from the most to the least is very large, due to the low barriers to entry, low continuing education requirements, and the lure of quickly making big dollars. For decades the industry has held the opinion that it's a profession, however the reality is that those outside the industry don't hold the same opinion. Most professions (doctors, lawyers, accountants, and engineers) require thousands of hours of study, beginning with a bachelor's degree. Even becoming an earth driller requires an average of 704 hours of instruction, and becoming a cosmetologist requires an average of a 372 hours. But to become a licensed real estate agent requires an average of only 70 hours with the lowest state requirement being 13 hours.

The delta between great real estate service and poor real estate service has simply become too large, due to the unacceptably low entry requirements to become a real estate agent. Professional, hardworking agents increasingly understand that the "not so good" agents are bringing the entire industry down.

"I don't like lawyers, but I rarely work with an incompetent one. I like real estate agents more, but there are a large number of incompetent ones."

AUTHOR'S PERSPECTIVE

There are too many real estate agents that are simply not qualified to the level they should be. Furthermore, there are no meaningful educational initiatives on the table to raise the national bar for real estate agents across the board. And while this lack of agent knowledge is a significant danger in itself, when combined with a lack of basic competency it could be destructive and harmful to both the industry and the consumer.

Danger Index

100.0

Probability

5.0

Timing

4.0

Impact

5.0

INDEX
Danger evaluated in terms of PTI to provide comparison between the dangers/sections of the report. Danger Index, represents a composite, overall score.

DANGER A2

COMMISSIONS SPIRAL DOWNWARD

A variety of powerful forces exert significant downward pressure on real estate commissions.

IN CONTEXT

The continued rise in home prices has facilitated the elevation of real estate earnings based on commissions. Those earnings have not gone unnoticed by consumers, who are responding by placing increased pressure on real estate agents to reduce their commission rates. As a result, many fear a gradual downward slide or a realignment of fees as charged in other countries in the world.

REAL ESTATE BROKERAGE FEES

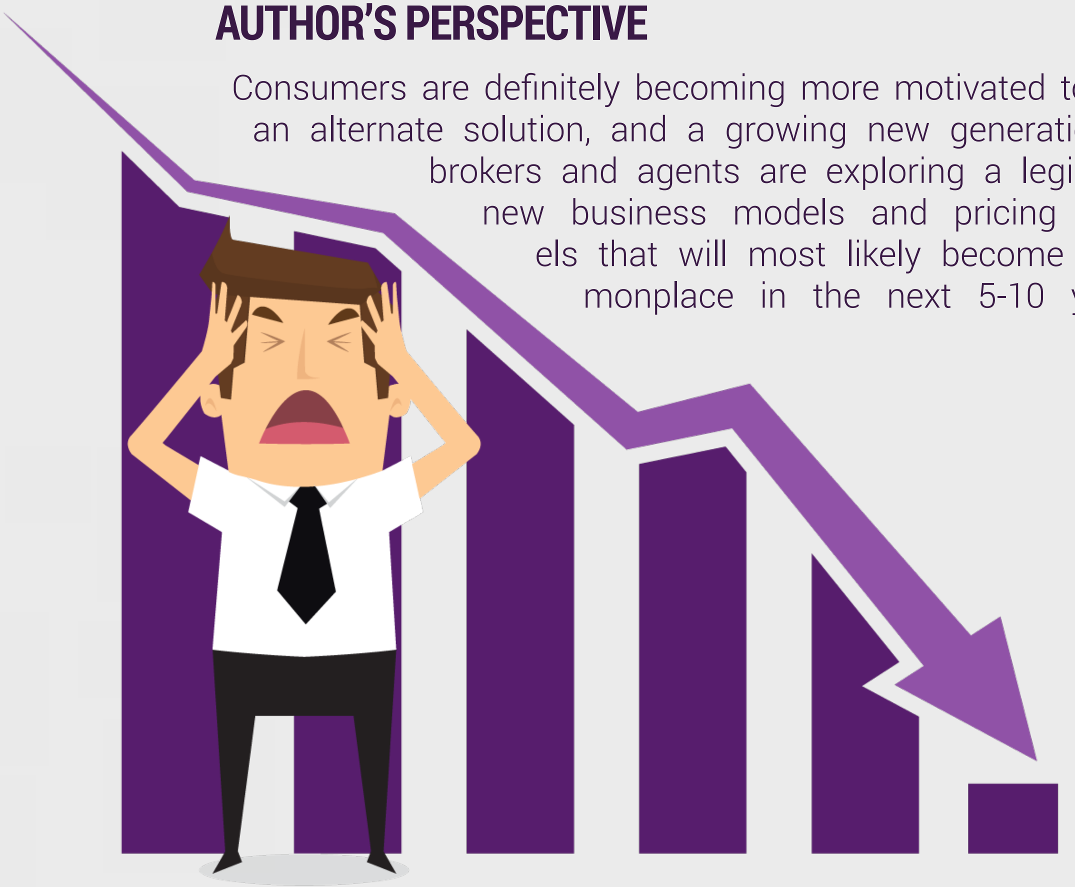
According to a report by the *International Real Estate Review*, real estate brokerage fees around the world are:

- **1 - 2%** United Kingdom
- **1.5 - 2%** Singapore
- **1.5 - 2%** Netherlands
- **2 - 3%** Australia
- **3%** Belgium
- **3 - 6%** Germany

> "Home buyers might not always want to use a real estate agent, but most think they have to. What happens if their perspective changes?"

AUTHOR'S PERSPECTIVE

Consumers are definitely becoming more motivated to find an alternate solution, and a growing new generation of brokers and agents are exploring a legion of new business models and pricing models that will most likely become commonplace in the next 5-10 years.



Danger Index

87.5

Probability

5.0

Timing

3.5

Impact

5.0

INDEX
Danger evaluated in terms of PTI to provide comparison between the dangers/sections of the report. Danger Index, represents a composite, overall score.

DANGER A3

AGENT TEAMS THREATEN THE SURVIVAL OF BROKERAGES

Teams cannibalize brokerage companies by siphoning off their profits, leaving them exposed to all the risk.

IN CONTEXT

The team concept has been around for a long time, but in recent history it has emerged as a much larger factor in the brokerage industry. Most companies have endorsed or at least tolerated the concept in light of the revenue it generates. However, there are issues that need to be addressed when teams function as an autonomous brokerage unit. From a marketing perspective they often develop their own brands, which in some instances become more powerful than the brokerage brand. Their self-directed status is enhanced by their ability to obtain their own technology and operate more efficiently and effectively for their own benefit. All of which presents the opportunity for the emergence of the "lead agent-centric" model, the company within the company.

Agent teams greatly expand the broker's potential legal liability as the master agent imposes standards and best practices on the team that have not been approved by either the brokerage or the broker's legal counsel.

Economics also come into play here. Master agents with teams tend to make more money than traditional office managers. So here again the industry's economic profile is being distorted when funds that arguably should be distributed as dividends are being expended for management or labor.

Danger Index

70.0

Probability

5.0

Timing

4.0

Impact

3.5

INDEX
Danger evaluated in terms of PTI to provide comparison between the dangers/ sections of the report. Danger Index, represents a composite, overall score.

AUTHOR'S PERSPECTIVE

Teams dominate and make it harder for solo agents to succeed and for companies to act as entrepreneurial as they may wish. There is a strong tendency for teams, as part of their business plan and their own identity/brand, to establish their own operating guidelines, standards, and procedures. Some of these independent decisions and actions may run afoul of Real Estate Settlement Procedures Act (RESPA) compliance or the Consumer Financial Protection Bureau, especially decisions involving Affiliated Business arrangements.

On the other hand, with good management and oversight, teams can become a strong growth opportunity as demonstrated by some large national franchises.

DANGER A4

IRS FORCES EXODUS OF INDEPENDENT CONTRACTORS

An IRS ruling is handed down that reclassifies the legal status of real estate agents from independent contractors to employees.

IN CONTEXT

Real estate law, which in most states requires brokers to supervise their agents, often conflicts with labor laws governing independent contractors. Furthermore, there are issues concerning the involvement of the IRS and the National Labor Relations Board that present challenges. These conflicts have opened the door for attorneys to bring suit against Boston Pads, Coldwell Banker, Redfin, and ZipRealty, claiming these organizations have misclassified their agents as independent contractors rather than employees.

The lawsuits assert that the labor laws controlling independent contractor status should take precedence over real estate law.

Employment law defines independent contractors in such a way that broker supervision can appear to undermine a contractor's independence. One of the widely adopted tests to determine a person's status is the Economic Reality Test (used by the U.S. Supreme Court) that examines the degree of employer control, the relative investment of both the employee and the employer, the opportunity for profit, the skill required, and the permanency of the relationship.

ECONOMIC REALITY TEST
Criteria used by the U.S. Supreme Court to determine if an individual is an independent contractor.

1. The degree of control exercised by the alleged employer;
2. The extent of the relative investments of the (alleged) employee and employer;
3. The degree to which the employee's opportunity for profit and loss is determined by the employer;
4. The skill and initiative required in performing the job;
5. The permanency of the relationship.

> *"Part-time agents are a huge risk to our future."*

Danger Index
63.0

Probability
3.5

Timing
4.0

Impact
4.5

INDEX
Danger evaluated in terms of PTI to provide comparison between the dangers/ sections of the report. Danger Index, represents a composite, overall score.

AUTHOR'S PERSPECTIVE

A decision by the Supreme Court going against the status quo, although unlikely, could have a far-reaching, industry-wide impact, including the transformation of the brokerage revenue model and a significant shift in the operational model.

A scenario in which agents are considered employees would initiate a complete reorganization of the existing revenue model. Most brokerage companies would be unwilling to hire agents that will not generate enough business to cover their costs. Employee status also does not necessarily include top wages and benefits for everyone. Consider the case of restaurant workers who exchange access to tips for an additional $2.13 minimum wage. Agents would thus have three primary options: work as an employee for a large company under its operational guidelines, become a broker and work as a sole practitioner, or leave the industry altogether.

DANGER A5 THE DECLINE IN THE RELEVANCY OF AGENTS

The role, function, and perceived value of agents deteriorates as agents fail to properly assess and respond to changing consumer demands and expectations.

IN CONTEXT

The real estate industry has long served the consumer at a local level, but in the opinion of many leaders it has never really had a firm understanding of consumers as a collective, let alone understood that consumers are constantly evolving and changing. The industry's most frequently cited weakness is its inability to understand what the consumer wants. The problem is that consumers don't care about agents—as much as agents would like to think consumers do—and the role of the agent not only can be, but is being redefined.

Furthermore, numerous participants in the industry are guilty of violating key parts of The Consumer Bill of Rights, especially the consumers' rights to be informed (of all the facts), to choose (from among competing services), and to be heard (to have all their questions understood and answered). The root cause is often the failure to listen, or worse, appearing to listen but failing to respond by focusing on the transaction and not the consumer.

AUTHOR'S PERSPECTIVE

Agent photos and self-branding are omnipresent in home sales. In many cases the promotion of the real estate sales person surpasses the importance of the house being sold. That's uniquely different to most other sales industries where the role of the sales person is secondary. Too many real estate agents believe their role is critical and their relationship with home buyers and sellers is beyond reproach. It's that kind of overconfidence that often results in failure.

"Time to clearly define the value proposition for REALTORS®."

Danger Index

60.0

Probability

5.0

Timing

3.0

Impact

4.0

INDEX
Danger evaluated in terms of PTI to provide comparison between the dangers/sections of the report. Danger Index, represents a composite, overall score.

DANGER A6

THE AGENT-CENTRIC ERA ENDS

The disproportionate power that independent contractors have enjoyed over the past three decades goes out of vogue as capital or economies of scale change the rules and the Wall Street reign begins.

IN CONTEXT

Unlike brokers, the majority of agents do not have the same level of financial investment in the industry. Many agents have been unable and/or unwilling to effect the changes the brokers need to build effective and profitable businesses. It remains a numbers game and brokers frequently don't make decisions that are in the best interests of the brokerage, they make decisions to appease their top-producing agents.

With the growing impact of technology, consumers are now wielding newfound power and imposing increased demands on the brokers through their agents, which further complicates the existing model and favors change.

"Technology is constantly evolving and agents aren't. The difference is noticeable and it's getting larger."

AUTHOR'S PERSPECTIVE

As real estate brokerage companies and franchise organizations continue to consolidate and expand in size, head count, and profitability, the obvious need for increased standardization of best practices and the implementation of best systems has become critical.

Going forward in the evolution of the brokerage business, there is danger in failing to address the legacy of fragmentation that was brought about in large part by agent-centricity, which has become a multilevel handicap to the brokerage business and the ability of brokers to adapt and move forward.

To realign from an agent-centric model, significant time and money will need to be invested in realigning company assets to ensure that the organization's foundation will be able to sustain, or carry, the scalability of size required to change the paradigm. And in many cases that scalability will need to be added on top of an existing, fragile, and in some cases inadequate structure. In the process, the importance of the sales associate and a strong and powerful sales team should never be underestimated or underappreciated.

Danger Index

52.5

Probability

3.5

Timing

3.0

Impact

5.0

INDEX
Danger evaluated in terms of PTI to provide comparison between the dangers/sections of the report. Danger Index, represents a composite, overall score.

DANGER A7

HOUSING FINANCE SYSTEM FAILS

Mortgage-backed securities as a method of financing is discontinued because it's too risky and the related fines imposed on banks too severe.

IN CONTEXT

The U.S. has $9 trillion in outstanding home mortgages, not including $1 trillion in seconds and home equity loans. In response to the financial crisis, the Fed began quantitative easing (QE) to stimulate the economy, including purchases of mortgage-backed securities (MBS) issued by Fannie Mae and Freddie Mac.

One of the most significant effects was a decline in mortgage rates to generational lows, which supported the housing market and the economy during one of its most vulnerable periods.

The financial crisis highlighted the importance of the secondary mortgage market and the vulnerability of financing for homebuyers in times of crisis. Should lenders decide to move away from mortgage lending because of onerous regulations or increased risks in the secondary market, home buyers' ability to access affordable mortgage financing would be severely limited.

Danger Index
48.0

Probability
3.0

Timing
4.0

Impact
4.0

AUTHOR'S PERSPECTIVE

When and to what extent Fannie Mae and Freddie Mac are revamped or replaced remains unknown. A secondary market that is not available in all economic climates and that does not preserve access to affordable mortgage financing for qualified home buyers would place agents and the entire industry in jeopardy.

INDEX
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DANGER A8

COMMODITIZATION OF RESIDENTIAL REAL ESTATE

The concentration of residential ownership into the hands of a few large investors commoditizes residential real estate and impacts market dynamics and liquidity.

IN CONTEXT

The significant increase in the liquidity of residential real estate brought on by the slow down starting in 2006, the emerging foreclosure crisis of 2007, and the recession of 2008, created the peril that institutional investors would acquire and control major housing resources as a sound long-term investment asset. Over the past few years Residential Real Estate Investment Trusts (RREIT) have grown and publicly traded companies like Blackstone and Colony Financial currently own one and a half percent of the approximately 14 million rental homes in the U.S. RREITs have expended $20 billion to acquire somewhere near 200,000 single-family rentals in just the last two years.

The type of single-family rentals desired by RREITs and their location is remarkably consistent: the ideal asset is a three-bedroom, two-bathroom house in a good school district and close to jobs. Like individual homebuyers, these institutional investors prefer long-term appreciation and therefore their target markets are infill neighborhoods over the new “exurban” communities.

Largest RREIT companies and the total number of homes they own

43,000	Invitation Homes (Blackstone)
27,000	American Homes 4 Rent
16,000	Colony American Homes (Colony Financial)
11,400	Starwood Waypoint
8,200	Altisource Portfolio Solutions
6,000	American Residential Properties
5,600	Silver Bay

Source: nasdaq.com, Seeking Alpha, CoStar Group, 2014

"Wall Street has discovered constant housing income streams."

AUTHOR'S PERSPECTIVE

When a small number of RREIT companies own a large number of homes, they have the ability to place a large number of homes on the market at the same time, possibly depressing values. Some are even exploring partial ownership or the right to use the home for a certain time period without becoming the owner. It has been estimated that this represents a $1.5 trillion opportunity.

The single-family market could follow in the footsteps of the multifamily market, with a large percentage of all rental homes eventually being owned and managed institutionally. This could, over time, change the market dynamics of neighborhoods and subsequently the neighborhood agent.

Danger Index

42.0

Probability

3.0

Timing

3.5

Impact

4.0

INDEX
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DANGER A9 COMMISSIONS CONCENTRATE INTO FEWER HANDS

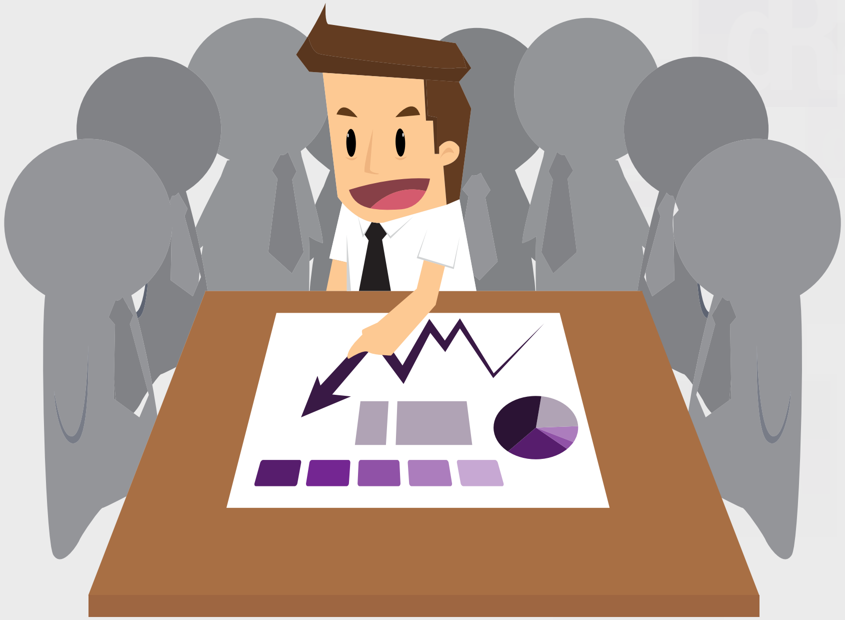
A very small group of very efficient and effective agents discover the winning formula and secure a disproportionate market share.

IN CONTEXT

The 80/20 rule (Pareto Principle), or some variation thereof, most certainly applies to real estate sales. Few agents are responsible for a large portion of all real estate sales.

In a recent book titled *80/20 Sales and Marketing,* author Perry Marshall takes the Pareto Principle to the next level. This can also be expanded such that the 80/20 rule also exists within the top 20 percent. Meaning that the top 20 percent of the top 20 percent (or the top 4 percent overall) represent 64 percent of sales.

"We don't need more agents. Just better ones."



AUTHOR'S PERSPECTIVE

As the industry successfully adapts to an ever increasing amount of technology, there are agents that have learned to create systems that leverage themselves to even higher levels, with a number of closed transactions not previously achieved. And there are a rapidly growing number of rookies that are also finding success much quicker and at a higher level than has previously been the case.

Danger Index

40.0

Probability

4.0

Timing

2.5

Impact

4.0

INDEX
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DANGER A10 THE AGENT IS REMOVED FROM THE TRANSACTION

A tech company cracks the code and connects enough of the dots to conduct real estate transactions without the need of an agent.

IN CONTEXT

The industry has always had a group of homeowners that have attempted to conclude the sale of their home without the help of a licensed real estate professional, thereby attempting to save all or a part of the commission. Commonly referred to as FSBO (For Sale By Owner), this market segment has historically remained constant at around 10 percent of the total market. While certain lower economic profiles may be the central focus of today's growing consumer cash consciousness, it isn't the only driving force. There are consumers who consider independence from institutional norms to be a symbol of successful lives. Self-healing, doing your own taxes, growing your own food, and involvement in all aspects of life are positive personal goals for many.

With the Millennial Generation drawing closer to its natural home buying juncture, it's obvious that their "first time" will not be as easy as it was for the Civic or Boomer generations. To start with, the opening economic profile for the Millennials is not what it was for their predecessors. It's generally believed that the younger generations will have less cash to work with and more challenging financial thresholds to meet. As a result, Millennials will be looking for ways to shave costs from their real estate transaction. At the other end of the spectrum are the Boomers who are seeking to downsize from large homes to more affordable, "sized right," and accessible housing options. Their primary objective will be to convert as much of their equity into cash as possible. Shaving costs from their real estate transaction may also become increasingly important.

Examples of New Models

- Uber
- AirBnB
- TurboTax
- LegalZoom
- ScottTrade

"The 'UBERIZATION' of real estate threatens agents the same way it did cab drivers."

"Agent-centricity may be our downfall."

AUTHOR'S PERSPECTIVE

Some consumers may be dissatisfied with how complex the home buying process is, but most of them can't do anything to change that. There is one element that can change all of that: Money. Keep in mind that FSBO doesn't necessarily mean without assistance—it means without an agent as we know it today. Consumers are availing themselves of alternative options regarding search and research.

Furthermore, business models constantly change. Portals that may never have had the intention of being brokers may believe they have to, and an e-commerce or online auction company providing consumer to consumer services via the Internet may decide to expand their channel into residential sales.

The bottom line is that change is certain. It is the approach that's an unknown.

Danger Index
31.5

Probability
3.5

Timing
3.0

Impact
3.0

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DANGER CHECKLIST: DANGERS IMPACTING AGENTS

DATA CLASSIFICATION

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3.0	60% Chance	3 - 5 Years	Moderate Impact
2.0	40% Chance	5 - 10 Years	Some Impact
1.0	20% Chance	10 + Years	No Impact

Danger Index	
81-100	Critical
61-80	Severe
41-60	High
21-40	Moderate
0-20	Low

		Danger	Probability	Timing	Impact	Index
☐	A1	Masses of Marginal Agents Destroy Reputation	5.0	4.0	5.0	100.0
☐	A2	Commissions Spiral Downward	5.0	3.5	5.0	87.5
☐	A3	Agent Teams Threaten the Survival of Brokerages	5.0	4.0	3.5	70.0
☐	A4	IRS Forces Exodus of Independent Contractors	3.5	4.0	4.5	63.0
☐	A5	The Decline in the Relevancy of Agents	5.0	3.0	4.0	60.0
☐	A6	The Agent-Centric Era Ends	3.5	3.0	5.0	52.5
☐	A7	Housing Finance System Fails	3.0	4.0	4.0	48.0
☐	A8	Commoditization of Residential Real Estate	3.0	3.5	4.0	42.0
☐	A9	Commissions Concentrate into Fewer Hands	4.0	2.5	4.0	40.0
☐	A10	The Agent is Removed from the Transaction	3.5	3.0	3.0	31.5

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An Official Extract from the **D.A.N.G.E.R.** Report

the definitive analysis of negative game changers emerging in real estate

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