



AUGUST 2019 NEWSLETTER

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DID YOU THINK THE RANKINGS WERE OVER?

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COMPLIMENTS OF



BUILDING SPECIALNESS

CREATING A MEMORABLE EXPERIENCE FOR AGENTS, BUYERS, AND SELLERS

Many of the best performing brokerage firms had a particular “specialness” that played a role in their success.

*By Steve Murray,
president*

Retailers of goods and services are told that they need to build a shopping experience to attract and retain customers. It's not just about the products and services that one offers; it's what the merchant does that makes the experience memorable that matters as much as the quality of the goods or services.

HOW CREATING AN EXPERIENCE RELATES TO BROKERAGE

Thinking about this facet of modern-day residential brokerage caused us to think about great brokerage companies and national realty organizations. Which of them has achieved superior success over the past 30 years? Was there a part of that success that was due to *specialness*? Is there something to be learned from the past that points one way forward for brokerage firms or, for that matter, individual agents or teams?

The answer is yes. Many of the best-performing brokerage firms and national realty firms had that certain distinctive quality that played a significant role in their growth and success. Here are some of the attributes that we think mattered:



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- 1. Leadership.** There was a passionate, involved leader who communicated the purpose, mission, and values of the organization regularly and consistently.
- 2. Marketing.** There were specific attributes that the firm highlighted that made them different from their competitors. These may have been commission plans, but more frequently, they were business model differences, technology tools, marketing platforms, and educational offerings.
- 3. Communication.** The leadership also communicated not only how the above attributes benefited the participants in the organization but also how it made them different from others. That helped the participants feel they were part of a special organization.
- 4. Relationships.** The leadership at all levels worked diligently to build relationships among the participants and the leadership team.
- 5. Storytelling.** The leadership built stories about the people and achievements, and that reinforced a sense that the organization was exceptional in some way.

WITHOUT A DISTINCTIVE DIFFERENCE
built on the characteristics listed above, an organization will be challenged to achieve above-average results—and average results in tough competitive markets won't work well.

Organizations must have financial discipline and operational structure. The specialness won't matter when a firm can't manage its business well. But without a distinctive difference built on the characteristics listed above, an organization will be challenged to achieve above-average results—and average results in tough competitive markets won't work well.

BRIGHT FUTURE

We believe that brokerage has a bright future, regardless of today's challenges. There are new local, regional, and national realty firms being born every day. Some will achieve a level of success beyond what most might think probable or possible. We believe that building specialness is what will separate those that succeed and all the others. ☀

FUN FACTS



REAL TRENDS + TOM FERRY AMERICA'S BEST REAL ESTATE PROFESSIONALS RANKINGS

The results are in, and we calculated some facts about this ranking.

- The total number of individual agents and teams that met the qualifications in 2018 was just over 14,500 up from approximately 13,500 in 2017 or an increase of 7.4 percent.
- The total closed sides done by all 14,500 was 1,088,000, and the total closed sales volume was \$420.3 billion.
- Approximately 1.5 percent of all the Realtors® in the country handled nearly 10 percent of all closed transactions and almost 24 percent of all the closed sales volume done in the country in 2018. Each of these numbers represents new record highs for Americas Best Real Estate Professionals.



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REALOGY VS. COMPASS: ANALYSIS AND POSSIBLE IMPACT

On July 10, Realogy announced it had filed an action against Compass. Here's the REAL Trends analysis.

By Steve Murray, president



The lawsuit filed against Compass was for “unfair business practices and illegal schemes to gain market share at all costs and to damage, or even eliminate competition. To reach its desired ends, Compass steals from, interferes with, and disparages its competition.”

A few observations about our industry as it pertains to the claims by Realogy. First, predatory, borderline, and unethical activity in the recruiting of agents has occurred ever since the National Association of Realtors® (NAR) dropped its anti-solicitation clause from the NAR Code of Ethics 40 years ago. Most brokerage firms could cite various times when their agents were recruited through the spreading of disparaging, often untrue, statements about the target brokerage. Most leaders can recall incidents of what would be considered unethical conduct in terms of recruiting tactics.

UNETHICAL RECRUITING TACTICS

How about a broker that showed up in the lobby of a hotel where a competitor was holding its Christmas party and attempted to recruit people on the way to the party? How about a brokerage that put fliers on the windshields of agent’s autos when they are at a company luncheon? What about recruiters who tell targeted agents that they know *for a fact* that the company is selling or is going out of business? Each one of these is a true story, and some of this conduct continues to this day.

FINANCIAL INCENTIVES

As to the offering of financial incentives to lure agents to another firm, that too has been going on for 40 years. The 100 percent commission plan was just one example of offering financial inducements for agents to leave one firm and join another. There have been many others and more today than ever before. Compass’s offering of

We could go on about this but would be pounding the rubble on this topic.

TORTIOUS INTERFERENCE

As to tortious interference in contracts, this is another matter altogether. I have personally been involved in 11 or 12 cases of claims of tortious interference in franchise contracts in my career. In every case, the plaintiff won damages against brokerage firms that interfered in a franchise agreement. Thankfully, this was years ago, and most brokerage firms know not to tamper with franchise agreements.

I have also been personally involved in two cases of interference and breach of employment agreements in the past. In both cases, the judges found the non-compete unenforceable but found that the non-solicitation agreement was enforceable. In both cases, the judges found for the plaintiffs who had been harmed by the breach of an employment agreement with non-solicitation agreements in them. In one case, a judge found that the defendant’s behavior was so egregious that the judge commanded that a special master henceforth would handle all communications between agents and employees for a set period.

Most brokerage firms could cite various times when their agents were recruited through the spreading of disparaging, often untrue, statements about the target brokerage. Most leaders can recall incidents of what would be considered unethical conduct in terms of recruiting tactics.

money and stock options is just another example, except that they have tons of money to spread around. It makes them a more deadly and threatening competitor than many from the past.

INDUCING MANAGEMENT-LEVEL EMPLOYEES

Thus, a firm that may be trying to induce management-level employees—who have non-compete and non-

solicitation agreements with their current employers—to depart that employer and breach their agreements may be adjudged to have committed both a tortious interference claim and a breach of contract issue. Not being an attorney, I really couldn't say which.

We have for years, in all of our public statements and written articles, stated quite clearly that we believe in the sanctity of contracts whether franchise agreements or employment agreements. Where a firm is found to have caused someone to breach such an agreement, we think it's actionable by the harmed party.

REALOGY'S CLAIM

Lastly, as far as Realogy's claim that Compass is trying to put competitors out of business, there would likely be thousands of co-sponsors join them in this part of their claim. While

Compass may not have a stated aim to put Realogy, Berkshire Hathaway, Keller Williams, RE/MAX and thousands of other brokerage firms out of business, their business strategies are harming the economics of brokerage.

We've seen more than enough financial statements of its competitors than to think otherwise. Again, it's only its size and financial resources that make Compass any different than HomeSmart, Realty One Group, JP and Associates, eXp and Fathom who have very low-cost options for agents and are also having an impact on incumbent brokerage operations. Compass is merely using their access to large amounts of capital to expedite the growth in their market share faster than more traditional recruiting tactics may take them.

SUMMARY THOUGHTS

We are fond of saying to our brokerage clients that if it were always and only about the financial aspect of a relationship between a brokerage and an agent, then every incumbent in the country would be out of business. This is not the case. Compass has not and will not likely achieve its goal of 20 percent market share in their 20 markets by 2020. We can look at our rankings of the 1,750+ top brokerage firms and 14,500 top-ranked agents and teams to see that they won't likely get enough of them to get there in all these markets. It's just a matter of who the incumbents are in each market and how well many of them have already adapted to Compass and other, low-cost competitors.

I have no idea where this challenge from Realogy will end. Time will tell. ▶

NEW REALTOR® MEMBERSHIP LEVELING OFF

Indications are that the growth in new Realtor® membership may be leveling off.

By Steve Murray, president

Recent informal discussions with leaders of some of the larger state and local associations of Realtors® revealed that the rapid growth of membership might be leveling off in many markets. This is just as total membership has recovered from the recession low in the 950,000 level to nearly 1.4 million.

One outcome of this could be intensified competition for those

already in the business. With new, low-cost competition throughout the market, this can't be good news for incumbent brokerage firms. It also reinforces the need for all brokerage firms to revisit their offerings so that they are more tailored to this new environment. According to our rankings, the highest producers in the industry appear to have captured nearly 25 percent of all housing sales volume in 2018.

With the emergence of the iBuyer companies and other forms of low-cost brokerage firms, the total market share of both agents and transactions is shrinking from where it was three to five years ago.

The ability to build a brokerage company in this environment remains bright, but it is not what it was in the past. ▶



SALES MEETINGS THAT SIZZLE

Your 10-step plan for sales meetings that agents want to attend.

*By Larry Kendall, author of *Ninja Selling* and Chairman Emeritus of The Group, Inc.*

Your sales meeting is the culture point of your office or company. Have excellent sales meetings and attendance soars. Your tribe gets bigger, stronger, and more connected. Retention and recruiting improve. Momentum, rising

market share, and profitability follow.

How do you create great sales meetings? Here's a simple 10-step template that helps you plan for a one-hour meeting that sizzles.



Have excellent sales meetings and attendance soars. Your tribe gets bigger, stronger, and more connected. Retention and recruiting improve. Momentum, rising market share, and profitability follow.

1. Return on Investment (ROI). Make sure your people feel that they're getting a return on their investment of time. Make the meeting memorable. When associates stay afterward and talk about what they learned or are repeating it the next day, you know you've made a difference for them.

2. Goals. A great sales meeting accomplishes as many of the following goals as possible: Connection, Information, Education, Inspiration, Motivation, and Celebration. If you're achieving these goals, your people will be drawn to your meetings to get their energy fix. They love the energy, learning, and being part of a tribe. Playing upbeat music before and after the meeting adds to the energy.

3. Appeal to the four personality types.

- **Power People** want takeaways (something they can use today in their business.)
- **Party People** want to know that they'll get to talk.
- **Peace People** want reassurance that the company and the market are safe and OK.
- **Perfection People** want to see some numbers, so make sure you provide market statistics. Also, have a printed agenda for your meetings.

4. Start on time. (First 5 minutes) Start without really starting. Have you heard of "Realtor Time" (five minutes late)? So, start with a 5-minute inspirational video. The perfection people will appreciate starting on time.

The party people will get there by the time the video is over and feel they made the meeting without being embarrassed for being late.

5. Welcome and opening activity

(5 minutes). Welcome everyone (including guests) and start with a group activity. "Turn to the person sitting next to you and share what you are grateful for," is an example. Or, "Get into small groups of four or five and share the best deal you know about in the market." Party people (the largest group of associates) love this exercise because they get to talk.

6. Celebration! (2 to 5 minutes). Find something to celebrate. Party people love this because it's fun. Peace people love it because it means all is OK.

7. Announcements, builders, property pitches.

(20 minutes). This is the information stage of the meeting. Have market data for your perfection people. Format this section, so you have control of the time. Do not hand your meetings over to outsiders—lenders, title officers, or builders. If you have a new home neighborhood to announce, make sure the builder knows the time constraints. Unfortunately, too many sales meetings stop right here and become only information meetings. When that happens, energy starts to leak out of the room, and people stop coming.

8. Program. (20 to 25 minutes). This should be the main event. It's the

primary reason your people are showing up. The program needs to provide a takeaway. Something they can use TODAY! Your best programs often come from your people sharing how they do something. The takeaway needs to be consistent with your culture and vision. If resources are required for your people to execute the takeaway, you need to have the resources set up at the meeting. Avoid, "We'll be getting you the _____ over the next few days or weeks." They want it NOW! They are motivated to act NOW! Keep the momentum going.

9. Finish with high positive energy.

If you need to cover negative information, cover it earlier in the meeting. Always finish on a high positive. Hopefully, the program will end on a high positive note. If not, finish with an inspirational video.

10. End on time. Meetings that run overtime are like a fish. They start to smell. People gradually drift away. Respect your people's time. Control the agenda. Follow these 10 points, and your meetings will sizzle and so will your company! ☀

**Meetings that run overtime are like a fish.
They start to smell. People gradually drift away.
Respect your people's time. Control the agenda.**



HOUSING SALES SLUMP CONTINUES

What's going on with housing sales?

By Steve Murray, president

May existing-home sales continued a 13-month slide in year-over-year results. This is despite a nearly 50-basis point decline in the benchmark 30-year mortgage rate to rates that are once again below 4 percent, a modest increase in inventory levels and moderation of rising prices for both new and existing homes. Lastly, this is in the face of the lowest unemployment rates of several generations among virtually every demographic group in the nation.

TELL ME WHY?

So, what gives? For the past 40 years, when any of these factors pointed the same direction as they are now, housing sales would take off. Now, with every factor in favor of housing, we see month-over-month declines in existing home sales and flatness in the new home sales segment. Here are some thoughts.

- New, single-family home construction has not recovered to anywhere near its record highs in the 2004-2005 period. They are barely above one-half of that level. They are at a lower level than almost any year in the past 30 years.

- Boomers are at the stage where they desire to downsize, but there's little inventory available to allow them to do so at an affordable price. So, many are sitting on their homes until opportunities come along.
- Millennials and Gen Z want entry-level housing to begin their journey to a life of homeownership, but there's little inventory available. Plus, this is also the market where investors and Boomers are looking for housing. This fierce competition is driving up the cost of homes in this segment well above the per-square-foot price of larger homes in many neighborhoods.
- The mood of many communities, towns, counties, and even some states has turned bearish against home building and growth due to crowded streets, parks, and other amenities. Recently, a major suburb of Denver passed legislation limiting new home construction to no more



than 1 percent of the existing stock of homes. A recent report in *The Wall Street Journal* pointed out that in many east and west coast cities, the level of new home construction is at record lows as well—just as employment and new household formation are reaching record levels in those same locations.

THE BOTTOM LINE

The bottom line is that unless (and until) government reduces the cost and complexity of new-home construction, which would ease the many bottlenecks blocking such construction, there's little way the housing market will change from its current condition. That is unless you think a significant recession in the general economy will help. □



FOR A GOOD READ, and to help you understand many of these factors, download and review the State of the Nation's Housing by the Joint Center for Housing Research at Harvard University. It's an eye-opener.

JUNE'S NORTHEAST REGION BUYER TRAFFIC SHOWS MODEST IMPROVEMENT

Demand in Other Areas Remains Sluggish, Consistent with Seasonal Patterns

KEY POINTS:

- The Northeast Region reported a 0.9 percent year-over-year increase in showing traffic, the first time it has recorded two consecutive months of increases since March 2018 – April 2018
- As a whole, June showing traffic across the U.S. was down 1.8 percent year-over-year, but it was the smallest decline since August 2018
- Year-over-year showing activity declined in the West (5.8 percent), the smallest drop in the region since May 2018; in the South (1.5 percent), and in the Midwest (3.9 percent)

For the second consecutive month, the Northeast Region reported a more modest year-over-year increase in buyer traffic while the rest of the U.S. saw signs of showing activity stabilizing, according to the latest ShowingTime Showing Index® report.

The 0.9 percent year-over-year increase in the Northeast is a positive sign for the region that had, until May, seen a full year of slower activity. Though the West, South and Midwest regions each saw drops in year-over-year activity, the declines were more modest compared to prior months. The West Region's 5.8 percent decline is the smallest percentage

decline in the region for more than a year, while the South's 1.5 percent dip is the lowest since September 2018 – the last time the region saw a year-over-year increase in buyer activity.

"Year-over-year showing traffic continues to stabilize, as June's overall activity was in line with June 2018 while the Northeast Region recorded a modest increase," said ShowingTime Chief Analytics Officer Daniil Cherkasskiy. "Activity in the South and Midwest remains slightly slower than in 2018, though there is more buyer activity in the lower price quartiles of the market. Pricier homes continue to see less traffic compared to the same time last year."

"YEAR OVER YEAR showing traffic continues to stabilize, as June's overall activity was in line with June 2018 while the Northeast Region recorded a modest increase. Activity in the South and Midwest remains slightly slower than in 2018, though there is more buyer activity in the lower price quartiles of the market. Pricier homes continue to see less traffic compared to the same time last year."

— **Daniil Cherkasskiy**
ShowingTime Chief Analytics Officer



ShowingTime® Showing Index

June 2019



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. 

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WITH STEVE MURRAY

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TODAY'S REGULATORY
LAY OF THE LANDA bronze statue of Lady Justice, blindfolded and holding a sword and a scale, symbolizing law and justice.

PART TWO: MARKETING SERVICES AGREEMENTS

Dramatic changes since Cordray's tenure means more opportunities for marketing service agreements (MSAs).

Find out what three attorneys have to say on the matter.

By Sue Johnson, strategic alliance consultant

Just a few years ago, a cloud of regulatory uncertainty hovered over Marketing Services Agreements (MSAs) after Consumer Financial Protection Agency (CFPB) Director Richard Cordray expressed his opinion in a 2015 MSA Compliance Bulletin that any settlement service arrangement anticipating future referrals was suspect under the Real Estate Settlement and Procedures Act (RESPA). The guidance was vague and confusing, but one thing was clear, the CFPB believed that MSAs were inherently illegal, and you had to prove that yours was not.

Since then, CFPB leadership has changed hands and the D.C. Circuit Court of Appeals, in *CFPB v. PHH Corp.*, rejected Cordray's view that payments made by one settlement service provider to another in a referral arrangement violate RESPA even if they are for the fair market value of the services provided. So, what does this mean for companies considering or reconsidering real estate MSAs? Here's what three leading RESPA attorneys, Phil Schulman of Mayer Brown, Richard Andreano of Ballard Spahr, and Brian Levy of Katten & Temple had to say about today's regulatory lay of the land.

Remember that RESPA is still being enforced by the CFPB, plaintiff's bar, and state regulators. Legal analyses of MSAs can be fact-specific, so it's essential to consult with an attorney with RESPA compliance experience when creating your agreements.

A DRAMATIC CHANGE, BUT RESPA STILL THERE

"The change is really dramatic," Levy said. "The PHH ruling was strong. When RESPA states that *nothing* in RESPA shall be construed as prohibiting market value payments for services, *nothing means nothing*. The PHH case effectively gutted the CFPB's 2015 MSA Compliance Bulletin."

"You see folks reconsider MSAs," Andreano noted. "You no longer have a CFPB director who is hostile to MSAs regardless of what the law says. But, all the PHH case said was that RESPA says what we thought it said. You still have to structure an MSA in a compliant way."

THE COMPENSATION MUST BE REASONABLE

The attorneys all emphasized that to be RESPA-compliant payments under an MSA must be reasonably related to the fair market value of the marketing services. It should not be based on the expected volume or quality of business, and any periodic adjustments should not be based on results.

THE MARKETING SERVICES MUST BE "ACTUAL, NECESSARY AND DISTINCT"

Marketing services that are compensated should be actual, necessary, and distinct from the services that the real estate broker or agent typically performs in the course of their job. There should be no payments for nominal services or for services for which there has been a duplicative charge.

NO PAYMENTS FOR MARKETING TO INDIVIDUALS

The attorneys unanimously advised

against payments for direct sales pitches by real estate brokers or agents to individual customers. HUD's 2010 Interpretive Rule on home warranty company payments to real estate brokers and agents spells out why: RESPA prohibits payments for *referrals*, which are oral or written actions directed to a person which has the effect of "affirmatively influencing" their selection. Homebuyers and sellers are more likely to accept a real estate broker/agent's recommendation of a provider, so the broker/agent is in a "unique position" to "affirmatively influence" their selection. Therefore, compensation to a real estate broker/agent to market to individual customers is an illegal payment for a referral.

What does this mean for MSAs? "It's OK to pay for marketing to the general public, but it's not OK to pay for real estate agents' email promotions," Shulman said. "Real estate brokers shouldn't encourage individual marketing by pressuring their agents to refer business to the MSA partner, or require people to get pre-qualified by a mortgage partner." Andreano recommends focusing on more traditional forms of advertising, such as banner ads or signs. "The real estate agent shouldn't be chatting [up] the [MSA partner's] services," he said.

REGULAR MONITORING IS ESSENTIAL

Both MSA partners also need to ensure that the services identified in the MSA are performed through data collection and regular reporting requirements. "MSA partners have to keep on top of the real estate broker and be ready to debit payments if five services are paid

for, but only four are done," Schulman said. "You also should do annual on-site reviews."

THE MSA SHOULD BE DISCLOSED

Levy advised that the MSA be disclosed to the consumer, even in the absence of a specific disclosure requirement in RESPA regulations. "If you're hiding an illegal relationship, RESPA's one-year statute of limitations could be equitably tolled to extend the liability for violations past one year," he said. "With disclosure, any claim, regardless of merit, can be limited to the one-year RESPA time frame. There also could be a UDAP [Unfair and Deceptive Acts and Practices] issue under state or federal law that is generally minimized through disclosure."

CONSULT WITH A RESPA ATTORNEY

Finally, and most importantly, remember that RESPA is still being enforced by the CFPB, plaintiff's bar, and state regulators. Legal analyses of MSAs can be fact-specific, so it's essential to consult with an attorney with RESPA compliance experience when creating your agreements.

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. 

NO-DEAL BREXIT?

WHAT MAY HAPPEN TO REAL ESTATE IN THE UNITED KINGDOM

October 31 is the deadline for the U.K. to leave the European Union. What impact will it have on real estate in the area?

The next few months are going to be important for the real estate market in the U.K. as the discussion to leave the European Union (E.U.) moves quickly towards the October 31 deadline. Prime Minister Theresa May, who guided the first period of negotiation, resigned. It would appear that the ruling party is united in its decision to leave the E.U. on October 31, even without an agreement in place.

According to the U.K. publication, *The Week*, wages in the U.K. are growing faster than the rate of home price inflation. The job market remains buoyant, offering hope to prospective home buyers. According to the latest Rightmove Property Index, U.K. wage growth currently stands at 3.4 percent compared with house price growth of nearly 2 percent. London is the largest market in Britain and has seen average house prices drop by almost 4 percent over the last 12 months, according to the Office of National Statistics.

This is the biggest drop since the recession of 2009. Conversely, some areas in Northern England, Wales and Northern Ireland experienced year-over-year price increases of more than 5 percent.

Since the announcement of Brexit some years ago, the housing market has been marked by volatility and supply constraints, which has sustained prices in many areas. The question everyone is asking now is, "What would the impact of a no-deal Brexit be on the real estate market?"

WORST CASE SCENARIO?

A no-deal Brexit remains the default position if no agreement can be reached. The Bank of England predicted that, in the case of no-deal Brexit, the worst-case scenario could see average home prices drop by up to 30 percent, but there's no way of telling yet.

Surrenden Invest's Jonathan Stephens said that the housing market would react slower than the stock exchange, and he expects a slowing in the market without a largescale fall in prices with low unemployment and stable mortgage rates sustaining housing demand.

By Peter Gilmour, chief foreign correspondent

Banks may be less willing to lend in a no-deal scenario as the economic outlook would become riskier. It's expected that in a no-deal situation, the pound may fall sharply in value, which may give investors some opportunity to make strategic purchases.



A NO-DEAL BREXIT WOULD LEAVE THE U.K. WITH NO AGREEMENTS ON TRADE, CUSTOMS, TRAVEL, OR CITIZENS' RIGHTS.



A no-deal Brexit would leave the U.K. with no agreements on trade, customs, travel, or citizens' rights. Plus, there would be no transition period to give U.K. businesses and organizations time to respond to changes. We will watch developments with interest. ▶



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VALUING A SELLING OWNER'S FIRM

By Scott Wright, vice president



The foundation of the sales process is the valuation. Much like selling a home, pricing a brokerage firm to market value is critical as we prepare a firm for sale.

As trusted consultants in the residential real estate industry, we get the privilege of working with firms of all shapes and sizes. Whether branded by a major national franchise or independent, flat-fee or graduated commission plan, small or large, at REAL Trends we're here to guide our clients through some of the most important and life-changing decisions they make as owners. When an owner decides it's time to sell, it's our job to prepare them for what's usually an emotionally challenging journey.

A TEDIOUS PROCESS

Unlike pricing a home, valuing a brokerage firm is quite a tedious process. The financials are a crucial component that guides value, but numerous other factors must be considered. Some of these factors may manipulate the financials as we build our model for value. Expectation management is a huge part of this whole process.

When the primary asset of firms in this industry are independent contractors who can leave whenever they want, it's essential to understand the inner workings of an organization. With smaller-sized firms, we must take a close look at the concentration of sales, particularly the owners' contribution to company dollar if they list and sell—which in most smaller firms is the case.

IT'S ABOUT MORE THAN THE MULTIPLE

Interestingly, most owners understand the basic principle of value as a multiple of profits. Unfortunately, some don't understand the qualifiers

that go into profits. I've had many preliminary conversations with owners who use the bottom line of their Profit & Loss Statement as the number for their internal calculation of value only to find out that the actual number they should be using is radically different. In the valuation world, we use what's called Adjusted EBITDA (earnings before interest, tax, depreciation, and amortization.) The "Adjusted" part of the equation is often impactful for firms where the owners list and sell.

OWNER'S COMPENSATION

If owners draw their commissions like the rest of the agents, the impact may not be as significant. If they don't, the bottom line of the Profit & Loss Statement can be quite distorted. For example, if an owner generates \$500,000 in Gross Commission Income and, at that level, the standard company split is 85/15, then they should be drawing \$425,000 off the top. This would result in Company Dollar of \$75,000. Many times, we see owners not taking a conventional split and merely letting their commissions flow through the company. When owners do this, they pay themselves on the back end via distributions after the company pays all its bills, they get what's left.

The problem is that when owners do this, their perception of company profits is misguided. I've had owners tell me that they have profits of \$750,000. But, after analysis, we realize that this number is overstated because the owner ran their commissions through the company. Using the example above, if the owner drew their

commission like any other agent, then the company profit would be \$325,000 (\$750,000 in stated profits less \$425,000 that is the owners' commissions). Think of it this way; if this owner were to sell, then the owner isn't going to give the new owner all his commissions; he is going to keep 85 percent.

Ultimately, the income factor of a valuation is what a new owner can expect to make on a going-forward basis, all things being equal. If an owner is not drawing on the top end from their commissions earned, then an adjustment must be made to reflect a reasonable income factor accurately. This adjustment can be quite substantial. Again, using the example above, at a 3.0 multiple of adjusted profits, the value would be \$975,000 (3 times \$325,000), not \$2,250,000 (3 times \$750,000).

OTHER CONSIDERATIONS

There are other things to consider when it comes to how selling owners are compensating themselves. Are they drawing a salary? Is that salary at a fair market rate for the operational duties they're performing? Are the owners going to remain with the company after a sale? Are they going to continue to sell? Is the Company Dollar that the owners are generating on an adjusted basis a material portion of the overall Company Dollar? These factors and more should be considered as we build our valuation model. Owner activity is the first thing buyers look at when going through their due diligence. The bottom line: Expectation management is hyper-critical when preparing for a sale! ▶

► EXPECTATION MANAGEMENT IS HYPERCRITICAL WHEN PREPARING FOR A SALE!

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