D.A.N.G.E.R.

definitive analysis of negative game changers emerging in real estate

REPORT

researched and authored by

Swanepoel
T3 Group

commissioned by

NATIONAL ASSOCIATION *of* REALTORS®

the D.A.N.G.E.R. report

Definitive Analysis of Negative Game Changers Emerging in Real Estate

NATIONAL ASSOCIATION OF REALTORS®

The National Association of REALTORS® is America's largest trade association, representing over 1 million members, including NAR's institutes, societies, and councils, involved in all aspects of the residential and commercial real estate industries.

Our membership is composed of residential and commercial REALTORS® who are brokers, salespeople, property managers, appraisers, counselors, and others engaged in the real estate industry. Members belong to one or more of some 1,400 local associations/boards and 54 state and territory associations of REALTORS®

The term REALTOR® is a registered collective membership mark that identifies a real estate professional who is a member of the National Association of REALTORS® and subscribes to its strict Code of Ethics.

Working for America's property owners, the National Association of REALTORS® provides a facility for professional development, research, and exchange of information among its members and to the public and government for the purpose of preserving the free enterprise system and the right to own real property.

Message from NAR Leadership

We are an industry that values our entrepreneurialism. Being a REALTOR® is not a 9-to-5 job. It's not even a "job". It's a calling. The challenges we face every day are a mix of age-old questions of survival and trailblazing into the unknown. We need to account for both.

This *Danger Report* is a mix of yesterday, today and tomorrow. The truth is, there are a lot of challenges facing the industry. It's important to understand where we've been and where we are, but equally important to anticipate the forces taking shape that we can't yet see.

In an attempt to give 'voice' to these forces, we conducted confidential interviews with many of the top industry minds, from within organized real estate and from without. The result is this Report, which attempts to catalogue everyone's greatest challenges and concerns in one place as a starting point for industry-wide dialogue.

Of course, we will be stronger if we meet these challenges together. But the pace is quickening. We must be agile and nimble if we hope to be successful. Our deliberations won't come just from the boardroom. They will come in the hallways, the lobbies, and the walks between meetings.

We hope, in reading this Report, you are filled with both passion and resolve to engage in the debate about the future of our industry. By focusing on these challenges, we will make more opportunities than we ever imagined.

CHRIS POLYCHRON
2015 President
National Association of REALTORS®

STEVE BROWN
2014 President
National Association of REALTORS®

DALE STINTON
Chief Executive Officer
National Association of REALTORS®

CHRIS POLYCHRON
2015 President

STEVE BROWN
2014 President

DALE STINTON
Chief Executive Officer

STRATEGIC THINKING ADVISORY COMMITTEE

PURPOSE

To identify and gather data that may affect the future of the National Association of REALTORS®, and to monitor and research threats, opportunities, key trends and issues, particularly from the fields that may impact the industry, our members, the Association, and the real estate consumer. To create and deliver an annual report of their findings (including supporting materials) to the Leadership Team, Executive Committee, and Board of Directors.

COMPOSITION

Core of the Strategic Thinking Advisory Committee: 20 at-large members (one of whom is the Chair of the Young Professionals Network Advisory Board, and two who specialize in commercial), plus the Chair (appointed by the President), Vice Chair (appointed by the President-elect), Immediate Past Chair, the elected Leadership Team members (President, Immediate Past President, President-elect, First Vice President, Treasurer), the CEO and Senior Vice Presidents ex-officio (without a vote). Outside participants as needed (non-voting) based on the issues.

Foreword from the Strategic Thinking Advisory Committee

Looking ahead to the future, whether as part of our own business strategy or as members of the REALTOR® organization, requires that we assess the environment that is taking shape and evolving each day. New threats emerge and unexpected opportunities arise, even as we anticipate other developments in the businesses or the organizations with which we are affiliated.

But, effectively planning for the future requires a thorough understanding of the threats and challenges that the real estate industry faces today and during the next few years. As real estate professionals, one of our strengths is an ability to solve problems for our clients, so it is natural that we also want to find solutions for the threats that we see in our business and in our industry. Too often, however, we want to move quickly toward a solution, before we have a thorough understanding of the dangers we are confronting.

To help move the discussion forward in a meaningful and worthwhile manner, the National Association of REALTORS® Strategic Thinking Advisory Committee, along with Stefan Swanepoel, has created a report that seeks to describe as many of the threats and dangers as possible that may affect the real estate industry. At one time or another, each of us has probably had a conversation with a colleague in our office or at a meeting about many of the threats described in this report. Unlike these irregular, ad hoc discussions, this report brings together the collective wisdom and insights of professionals from all segments of the real estate industry allowing us to gain a more comprehensive view of the industry environment.

Each day, we see evidence of changes in the industry and our business that can be both exciting and unsettling. This report is a forward looking assessment of threats that could emerge from the perspective of agents, brokers, the National Association of REALTORS®, state and local associations and multiple listing services. The time frame during which any of these potential dangers could emerge ranges from months to years suggesting some threats have a higher level of urgency than others. If any of these threats do come to pass, either sooner or later, they could affect the industry with varied intensity. Some could even be "game changers," shifting the flows of information, capital, and profits in ways that we don't necessarily understand today.

While the publication of the DANGER Report is one step toward inspiring thought and conversation, we hope that it will go further by allowing your organization, brokerage, or association to begin a dialogue about the dangers you see. After reading this report, you may find areas where you agree and areas where you disagree with the assessment put forward. In either case, we hope this report will be a discussion starter that will help prepare you and your organization for the future.

COLLEEN BADAGLIACCO
2015 Chair
Strategic Thinking Advisory Committee

MICHAEL OPPLER
2015 Vice Chair
Strategic Thinking Advisory Committee

TODD SHIPMAN
2014 Chair
Strategic Thinking Advisory Committee

COLLEEN BADAGLIACCO
2015 Chair

MICHAEL OPPLER
2015 Vice Chair

TODD SHIPMAN
2014 Chair

SWANEPOEL | T3 GROUP

The leading management-consulting firm in the residential real estate industry. The Swanepoel brand has become synonymous with quality market intelligence by publishing its annual *Swanepoel TRENDS Report*, the *Swanepoel Power 200*, and the *T3 Tech Guide* as well as a large portfolio of white papers under the *Real Estate Confronts* brand. Founded in 1997, the company has over the last two decades has assisted over seventy percent of the industry's largest firms.

The Swanepoel | T3 Group serves as hosts of the annual T3 Summit, real estate's foremost leadership conference, where CEOs meet to address industry-wide challenges.

The Group is the also the creator of T3 Experts and T3 Fellows, providing top producing agents and fast growing teams the best practices and business systems needed to ensure success.

An extensive and experienced cadre of management consultants skilled in creating and implementing strategies for high growth organizations, conducting technology as well as risk and compliance audits is available through the consulting division T3sixty.

RETrends.com | SP200.com | T3Summit.com | T3Experts.com | T3sixty.com

Preface from the Author

The *D.A.N.G.E.R. Report* addresses one step in a strategic planning exercise by asking an important question: What are the threats that could impact the residential real estate industry?

We sometimes view the industry through a distorted lens based on limited facts and a lot of conjecture. We decided it was time to change that.

This Report is a bold attempt to help the industry wrap its arms around the future. The future is not doom and gloom but at the same time we should not underestimate it. Change will absolutely happen and you can bet the farm on that. The unexpected often occurs with a single event or a single company. Some risks or threats identified in this report may build slowly through incremental changes while others might be overnight surprises.

- Doubt everything, be profoundly skeptical.
- Be zealous in your pursuit of knowledge.
- Shatter conventional wisdom.
- Laugh at your disbeliefs.

The National Association of REALTORS® commissioned the Swanepoel | T3 Group to uncover, research, and index the potential threats facing the industry. And we did so by reaching out to more than 70 of the industry's leading CEOs

STEFAN SWANEPOEL
NYT Best-Selling Author

and thought leaders and to over 7,500 brokers and agents across the country.

The opinions of those interviewed were categorized into five key sections and the threats, risks, and dangers resulting from the interviews were analyzed and rated as to their probability, timing, and impact. Remember, this is an art and not a science; you are welcome to have a different opinion on our scoring of each danger.

We tried very hard to keep the information objective and apolitical, and remained one step away from providing solutions. That is the part we kept for you as the captain of your ship.

None of the dangers contained in this Report are predictions, trends, or allegations. Don't read too much emotion or negativity into any statement. See each danger for what it is—a potential threat that could impact you or some part of our industry.

Although we cannot predict the future, there is also nothing unusual about the future. Use this Report as a checklist and starting point to prepare. Information creates knowledge and knowledge produces confidence.

It is incumbent upon each of us to ensure that we are leaving a healthy and thriving industry to the next generation. To that end, I urge you to read this Report with the intent of not only becoming informed, but with a commitment to actively contribute to the future success of our industry.

STEFAN SWANEPOEL
Analyst/Author of the *D.A.N.G.E.R. Report*
New York Times Best-Selling Author
of 30+ Books/Reports
CEO Swanepoel | T3 Group

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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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Dangers Impacting Agents

Section A | First of Five Sections

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Section A

DANGERS IMPACTING AGENTS

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	2 - 3%	Australia
1.5 - 2%	Singapore	3%	Belgium
1.5 - 2%	Netherlands	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.

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.

> *"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 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

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

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.

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

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

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

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 CHECKLIST: DANGERS IMPACTING AGENTS

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.

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
5.0	100% Chance	1 Year	Game Changer
4.0	80% Chance	1 - 3 Years	Major Impact
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

Dangers Impacting Brokers

Section B | Second of Five Sections

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Section B

DANGERS IMPACTING BROKERS

DANGER B1 REGULATORY TSUNAMI HITS

Regulatory creep and large financial penalties increase compliance costs.

IN CONTEXT

The CFPB was established as a new bureau through the authorization of the Dodd-Frank Wall Street Reform and Consumer Financial Protection Act of 2010. It has overwhelmed each of the industries it has entered (Student loans, Automobile loans, Credit cards, and Mortgages) and, given its short but impressive history, there is every indication it will have a significant impact on national, large, and/or diversified real estate groups. The intent behind its creation is to:

- Give consumers a vehicle to enforce the provisions of the Dodd-Frank Act and other consumer financial protections laws.
- Educate the public about financial transactions.
- Utilize research to prevent future financial crises, such as another housing bubble.

In its mission to rebuild the mortgage banking landscape, the CFPB has attempted to examine every aspect of the home buying transaction and the roles of the various participants facilitating the transaction. Its investigations haven't been limited to the lenders whose practices were a large contributor to these recent changes; the investigations have extended to real estate brokerages. Important to note here is that the CFPB was also granted responsibility to oversee the Real Estate Settlement Procedures Act (RESPA), which was formerly overseen by the U.S. Department of Housing and Urban Development (HUD).

“Dodd-Frank is a train wreck.”

AUTHOR’S PERSPECTIVE

Only time will tell how much of an impact the CFPB will have on real estate brokers, resulting in increased costs due to compliance, increased risk for small brokers with limited capital, increased scrutiny on marketing agreements, and the increased risk of agents moving to firms with strict compliance in place. What we do know is that the failure to comply at any level is not an option, and the penalties for failure will be costly. Those who suggest that real estate service providers are not vulnerable under the Financial Services provisions need to remember that there has been little or no effective RESPA enforcement by HUD over the past decade. Most brokerage companies are either ignorant of the fact or believe they are in compliance with CFPB/RESPA regulations, however most are likely in violation already.

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 B2 PAPER BROKERAGES CAUSE DISRUPTION

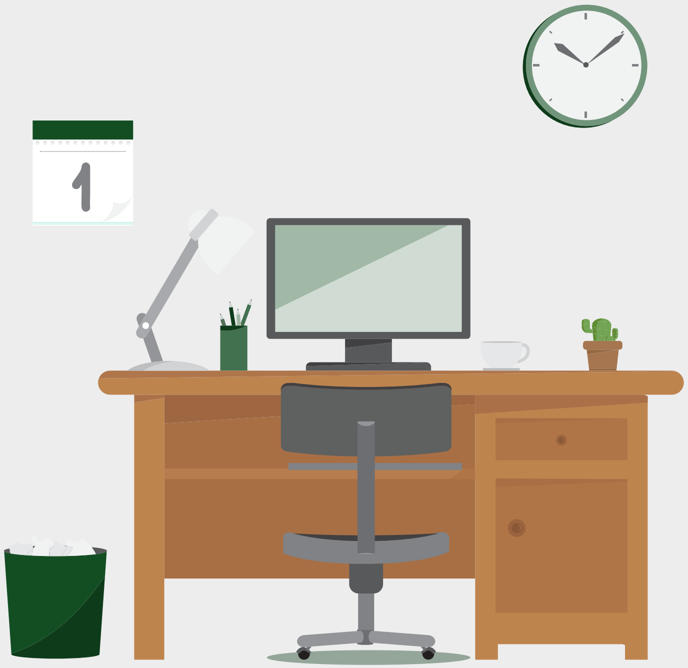
With no walls and little operating costs, Paper Brokerages proliferate and become a major force overnight.

IN CONTEXT

Paper Brokerages are companies that join multiple listing services (MLSs) in order to gain access to listing data and subsequently display it online. They do not, however, provide traditional brokerage services to consumers; they are created to generate leads for other brokerages. Paper Brokerages that obtain a brokerage license, or partner with a licensee who can be their "broker of record," are able to display Internet Data Exchange (IDX) listing feeds compiled by MLSs.

As Paper Brokerages don't have the same operating and cost structures as traditional brokerage companies, the concern is that they are "misusing" the MLS system and that the widespread adoption of the Paper Brokerage business model will undermine participation in IDX and the MLS system itself.

> “IDX is in a fragile state. We are fighting on the front patio with the back door open.”



AUTHOR’S PERSPECTIVE

As the real estate industry evolves and increasingly experiments with different business models, IDX opens a new variation of models not originally contemplated. Existing big brokers have become vulnerable because some MLS services have enabled non-traditional entrants (basically non full-time brokers) to utilize their information in a variety of ways. In some cases the owner does the negotiating and sale with the buyers agent and uses the cooperating brokerage company to facilitate the closing.

This shift has marginalized large brokers, causing many to consider withdrawing from the MLS, and others to question the viability of MLS going forward.

Danger Index
80.0

Probability
5.0

Timing
4.0

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 B3

BROKERS LOSE CONTROL OF DATA

Consumer confidence in industry data erodes due to the multiplicity of conflicting data sources.

IN CONTEXT

Traditionally, data was aggregated on a local level with an excess of terms, conditions, and criteria, all of which was deemed to be accurate. With the advent of the portals there is a movement toward the aggregation and syndication of data that has resulted in data collection from multiple sources that are not always kept updated, and is therefore compromised. The battle over the ownership of the data has resulted in certain data sources being disallowed, which in turn has further compromised the accuracy of the data.

Furthermore, the data mentioned really only refers to the listing data and, while it is a key piece, it is just part of the overall real estate data portfolio—tax records, insurance info, demographic records, mortgage loans, credit reports, drive times, lifestyle information, school performance, criminal activity, etc. So now the entire industry is focused on and concerned with controlling the consumer search process, which incorporates the creation, compilation, and distribution of all data.

"Mindsets have to change.

Margins have to change.

Management has to change."

AUTHOR'S PERSPECTIVE

Innovation pushes the boundaries of existing paradigms and mindsets with new opportunities that test both current and new players.

The struggle facing brokers is that decisions regarding the management of real estate data—with regard to the release, withholding, and application of data—are made by a fragmented industry and are very diverse and inconsistently implemented. Inaccuracy of data and ownership of such data has become a major issue in our industry.

As a result, there are numerous models that are constantly evolving, creating voids and roadblocks that many outside the industry view as opportunities. The industry finds itself at the early, challenging stage of laying down new rules and guidelines for managing real estate data with the delivery of unique content that is unavailable elsewhere.

Danger Index

72.0

Probability

4.0

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.

DANGER B4 A CONSUMER BRAND CRASHES THE PARTY

A well-established consumer brand is introduced into the marketplace and a new multi-billion dollar residential real estate brokerage brand is created.

IN CONTEXT

Historically, introducing a new brand from outside the residential real estate brokerage marketplace has been difficult, and considered by many as very unlikely due to the fragmented, hyper local, and highly personal nature of the industry. With growing consolidation in the industry and the increased addition of systems and technology, the previously held limitations on building a brand no longer apply.

Over the past decade, Realogy has proven that it is feasible to take certain "outside" brands such as BH&G and Sotheby's and successfully introduce them into residential real estate franchising. Warren Buffett has proven that a completely unknown brand in the residential real estate industry such as Berkshire Hathaway can be introduced and built into a new powerhouse.

AUTHOR'S PERSPECTIVE

It would not be a stretch for home improvement giants Home Depot ($133 billion market cap; $79 billion in annual sales) and Lowe's ($70 billion market cap; $55 billion in sales), to expand into the residential real estate brokerage business.

One example would be to take the model that Lowe's has, assisting REALTORS® in providing marketing benefits and finding savings for their clients, and expand it into an online lead generation service model. A second example would be to take Lowe's existing partnership program with construction and repair vendors and expand it into a type of DIY real estate model, while a third option could be to acquire a successful existing global real estate brand such as RE/MAX.

Other interesting possibilities could include banks or HGTV. They already have a recognizable brand in the financial or home lifestyle markets and can expand into, partner with an existing company to create, or leverage a new real estate brokerage brand. However, while the dollars are always enticing, the fragmented and byzantine structure of the industry goes against the nature of these organizations.

> *"New leadership at a large company often causes a change in the direction of that company."*

Danger Index

64.0

Probability

4.0

Timing

4.0

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 B5

NEW BUSINESS MODELS GO MAINSTREAM

The existing compensation structure gets eclipsed as new business models gain rapid traction.

IN CONTEXT

The relationship between brokers and agents has been redefined a number of times during the last 50 years. Each time the redefinition of the relationship resulted in the formation of a new company and/or group of companies. The innovations brought to the industry by those new companies caused a disruption in the industry that resulted in an increase in the number of agents jumping between companies.

In the 1960s and 1970s the franchise model created new national entities, in the late 1970s and 1980s the 100 percent model exploded, and in the 1990s and 2000s the interdependent and team model gained significant traction.

Each new business model led to new global companies that dominated the industry for decades. The next winning model could be a technology-powered, agent-centric, flat fee, transaction-based fee, salaried, or auctioneering model.

Danger Index

63.0

Probability

4.5

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.

“The residential real estate business is in turmoil. Everyone—brokers, agents, the MLS, associations—are all up for grabs... and brokers seem to be extremely vulnerable.”

AUTHOR’S PERSPECTIVE

It is interesting to note that over 40 percent of Fortune 500 companies in 2000 were no longer around in 2010, yet at the same time those top companies that were in the real estate industry in 2000 are all still here.

Two of the successful models, RE/MAX and Keller Williams International Realty, both took a decade (or more) to gain significant national critical mass. Interesting companies such as Redfin (in its fifth round of funding and in 48 metros), HomeSmart (a technology-offering already in place), and eXp Realty (a cloud-based virtual real estate brokerage) are still in early enough stages that in time they may become dominant national models.

The entrepreneurial spirit in residential brokerage is strong. Innovation of the broker/ agent relationship, whether initiated by internal or external forces, is just around the corner.

DANGER B6

BROKERS SIMPLY GO BROKE

Brokers are undercut by outsiders offering the same support and services at a fraction of the cost.

IN CONTEXT

Over the past couple of decades, brokers' control over their agents and the services they offered has shifted. This is changing the financial viability of the brokerage model. Many say it is being eroded by technology, and especially in recent times by portals. Portals capitalized on the slow responsiveness by brokerage companies that for a long time were either not able to, or chose not to, generate online leads for their agents.

Historically, lead generation hasn't been the responsibility of the broker as agents have generated their own leads from a variety of sources. Previously, no one single source could generate enough leads and therefore agents' relationships were not dependent on one entity. This is, however, changing as portals grow and become more powerful. For example, the largest portals have millions of homes viewed daily, and this in turn generates significant enquiries. Zillow has so many leads every day that they have been able to sign up over 60,000 agents to pay them for those leads. And many agents in turn have built a strong business from this source.

“Something is always displaced when something new is created.

That’s Capitalism.”

AUTHOR’S PERSPECTIVE

Not only are all leads not equal, not all leads are really leads. But maybe that doesn’t matter. With the explosion in online leads the portals created a new category of lifestyle and home searching that previously did not exist at this level. Now there are not only more home sales, there is more interest. And it’s the entities that control the interest that, diluted or not, gain access to the consumers.

It’s not that portals will put brokers out of business, it’s just one example of a service being offered to agents by third parties. And it is uncertain to what extent this relationship will undermine the relationship between brokers and their agents. The proliferation of the web has however most certainly triggered the transformation of the existing brokerage business model—for better or worse.

Danger Index

56.0

Probability

4.0

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.

DANGER B7

TECHNOLOGY BECOMES A RUNAWAY TRAIN

The financial resources necessary to build the technology solutions required exceed the average broker's ability to remain competitive.

IN CONTEXT

There is a widely held assumption that technology will make everyone and everything better. That's simply not true. But at the same time, technology has changed the world.

Around 40 percent of the world's population has an Internet connection today. In the early days of 1995 it was less than one percent. Within a decade the number of individuals connected to the Internet reached its first billion in 2005; a second billion in 2010, and a third billion in 2014. By the end of 2016 it is estimated that it will eclipse half of the world's population. As for connected devices, it is expected that the number will exceed 4.9 billion in 2015, up 30 percent from 2014, and will reach 25 billion by 2020. But the number of Internet users and connected devices drive many other consumer trends. Digital disruption is now felt on all levels of business. This huge wave of innovation makes it very hard for small real estate entrepreneurs to remain competitive and relevant.

AUTHOR'S PERSPECTIVE

Technology innovation has taken place at an alarmingly rapid rate, but brokerage companies aren't technology companies, nor are they structured to grow at this rate. Even many of the large brokerage companies and national franchises, with more capital than most in the industry, are unable or unwilling to invest the financial and human resources needed to compete with publicly funded technology companies. It never was a level playing field, but the gap is becoming wider and wider, and it will become increasingly harder for real estate brokerages to create or deliver the latest state of the art technology in any specific area. Things are just moving too fast.

> *"Beware of digital overload and technology fatigue."*

Danger Index

48.0

Probability

4.0

Timing

4.0

Impact

3.0

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 B8

FSBO DEVELOPS INTO A DO-IT-YOURSELF MODEL

With so much real estate information and so many apps at their fingertips, it has never been easier for consumers to buy and sell real estate.

IN CONTEXT

The For Sale By Owner (FSBO) option has been available in the industry for many decades, and has been used primarily on an individual basis (local level) by consumers that want to take control of the transaction in order to save money. The FSBO share of the real estate market in 2014 amounted to nine percent of the 5.1 million houses sold. Should this method be packaged in a more dynamic and formal offering—bundled together with a portfolio of technology and mobile applications—and be aggressively marketed and sold to consumers, the model could gain rapid adoption by a new generation.

Today's consumer is demanding choice in every aspect of the real estate process from search to closing, and there are numerous companies offering new tools in the DIY arena that are steadily empowering this "digital consumer." The question facing the industry is whether or not the DIY movement will become a major disruption to the way the industry currently operates, or will it just continue to bump along as it has in the past. There are numerous factors impacting that outcome, like FSBO sites that are using technology to reach out to the consumer at the outset of the process, providing them with a flexible DIY structure and an easy process to follow.

EXAMPLES OF DIY WEBSITES

FSBO.com

Owners.com

ListByOwnerInMls.com

BuyerCurious.com

10Realty.com

SalebyOwnerRealty.com

AUTHOR'S PERSPECTIVE

Community marketing opportunities can be found in many colleges, universities, hospitals, and other professional environments that experience high levels of employee relocation. These environments have in essence created and facilitated private property listing operations that enabled homeowners to sell their properties directly to new arrivals in their communities.

In a similar vein, more and more neighborhoods have undertaken to create websites that provide hyper-local information regarding a wide range of lifestyle related subjects. By enhancing the FSBO concept with an automatic value model, global portal exposure, access to standard forms, and with the emergence of 'RealtyZoom', an Enabled FBSO is increasingly being explored.

If this Do-It-Yourself variation of the traditional FBSO was to gradually double the existing FSBO niche, it could result in billions of dollars in real estate commissions being saved by the consumer and lost by the real estate industry.

Danger Index

42.0

Probability

4.0

Timing

3.0

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.

DANGER B9

SALES TAX THREATENS MARGINS

Sales tax on real estate commissions impacts already thin profit margins and forces fundamental change to the already strained broker/agent relationships.

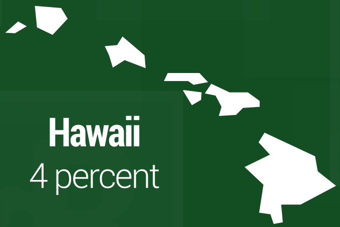
IN CONTEXT

States are scrambling for income in the face of declining tax revenues and increasing demands for services. Advocates have indicated that the taxing of services is simply a matter of fairness and good sense, and that there should be a "spreading out the tax burden" as widely as imaginable. According to the Federation of Tax Administrators, a majority of states apply their sales tax to less than one-third of 168 potentially taxable services.

For real estate, the touch point of taxes on "services" is the sale from the employer (broker) to the ultimate purchaser (consumer). To the extent that the tax is passed on, or built into the commission, it is owed by the broker, and thus increases the cost of the sale. In South Dakota for example, commissions received by a real estate broker under any type of agency agreement, or any fee originating from the sale of real property sold in the state—regardless of the broker's or agent's residence—are subject to state and applicable municipal sales tax based on where the property is located. The sales tax is due during the reporting period in which the broker receives the commission, determined by the time of closing.

STATES THAT TAX REAL ESTATE COMMISSIONS

Examples of states that have already introduced the taxing of real estate commissions.



Hawaii
4 percent

AUTHOR'S PERSPECTIVE

At the present time, sales tax on real estate commissions is not a widespread practice, but the danger of it gaining more traction is real and will increase as more state taxing authorities explore options for enlarging their tax base.

A service tax on commissions would have a direct impact on the sales price and the entire real estate industry as fees (and taxes) are—and have historically been—passed on to the consumer.

Danger Index
40.0

Probability
4.0

Timing
2.5

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 B10 PORTALS LEVERAGE LEAD GEN DOMINANCE

Portals leverage online dominance and morph their business model into a more aggressive transaction-based revenue sharing concept.

IN CONTEXT

It's estimated that the real estate brokerage industry annually spends between $6 to $10 billion on advertising and promotion. Historically this has been spread across multiple media sources, including printing, magazines, newspaper, and online advertising and promotional items. As the online portal channel continues to grow, a handful of companies now offer—for the first time—advertising options on a national basis, thereby consolidating the advertising revenue. At the present time the leading portal's revenue from that pool is approximately $200 million, which accounts for only about two to three percent of the total while their online traffic garners between 30 to 50 percent of the eyeballs browsing for houses. With portals' publicly stated goal to capture more of the agent ad dollar market revenue, it is not improbable that they may in the future capture 30 to 50 percent of the advertising dollars.

> *“Agents expect portals to act in their best interests...Why? Portals have no higher responsibility to the industry. They are a business, like everyone else, out to make a buck.”*

AUTHOR’S PERSPECTIVE

The re-directing of the industry’s ad dollars spent on new sources is significant, but it does not threaten the industry per se. It is, in essence, a consolidation and reallocation of existing advertising and marketing dollars.

The brokers’ fear is that once a national company obtains a dominant share, it may enable that company to change its revenue model to one based on transactions, resulting in a higher fee.

With a growing number of agents becoming increasingly dependent on portals to provide them leads, it will be interesting to see if this new source of lead generation becomes the dominant choice and thereby dramatically impacts other existing sources. Agents will most likely continue to work for brokers but may be less dependent on them as the result of their receiving a large number of leads via the portals.

Danger Index

36.0

Probability

3.0

Timing

4.0

Impact

3.0

INDEX
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DANGER CHECKLIST: DANGERS IMPACTING BROKERS

DATA CLASSIFICATION

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4.0	80% Chance	1 - 3 Years	Major Impact
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
☐	B1	Regulatory Tsunami Hits	5.0	4.0	5.0	100.0
☐	B2	Paper Brokerages Cause Disruption	5.0	4.0	4.0	80.0
☐	B3	Brokers Lose Control of Data	4.0	4.0	4.5	72.0
☐	B4	A Consumer Brand Crashes the Party	4.0	4.0	4.0	64.0
☐	B5	New Business Models Go Mainstream	4.5	4.0	3.5	63.0
☐	B6	Brokers Simply Go Broke	4.0	4.0	3.5	56.0
☐	B7	Technology Becomes a Runaway Train	4.0	4.0	3.0	48.0
☐	B8	FSBO Develops into a Do-It-Yourself Model	4.0	3.0	3.5	42.0
☐	B9	Sales Tax Threatens Margins	4.0	2.5	4.0	40.0
☐	B10	Portals Leverage Lead Gen Dominance	3.0	4.0	3.0	36.0

Dangers Impacting NAR

Section C | Third of Five Sections

Realtor.org/**DANGER**Report

DANGERReport.com

Section C

DANGERS IMPACTING NAR

DANGER C1 DECISION-MAKING STRUCTURE BECOMES A HINDRANCE

NAR's complex governance structure encumbers its ability to adopt the strategies, tactics, and policies that are appropriate for the future.

IN CONTEXT

Big national associations have a large, complex, and multi-tiered decision-making structure that is cumbersome by its very nature. To compare these associations and how they operate with an entrepreneurial-driven business isn't a fair apples-to-apples comparison. That said, the comparison is still made because the lines separating the two camps have been blurred. The National Association of REALTORS® (NAR) is the world's largest trade organization with 1,099,102 members as of December 31, 2014. It has approximately 2,500 members serving on approximately 80 committees, forums, and advisory boards, and its board of directors officially has a whopping 841 voting members.

By their very nature, contemporary trade associations that have a global reach are different than business corporations because they have to satisfy a much wider range of players on the business, professional, and cultural fronts. Decisions made in that environment are complex and often very unclear, regardless of how many individuals are on the committee. It is interesting to note that even large organizations in our industry aren't free from division and discourse, even those that have a single majority shareholder. Perhaps in the final analysis the danger exists because it's the nature of operating a huge organization.

AUTHOR'S PERSPECTIVE

What makes NAR unique is that it is one of the few trade associations that represents the interests of both the officers (brokers) and the enlisted ranks (agents) within the industry. Many have historically seen serving as a NAR director as a badge of honor with various perks. It's time to let go of the Boomer Generation association groupies who have become hooked on the benefits, including status and travel. Today, both companies and individuals are held to an even more business-like and more transparent standard.

> *"Leaders desiring to win need to be nimble. NAR governance makes it very difficult to respond quickly."*

Danger Index

100.0

Probability

4.0

Timing

5.0

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 C2 THE THREE-TIER STRUCTURE LIABILITY

The unique three-tier REALTOR® Association structure emerges as the trigger of major crippling channel conflicts between national, state, and local REALTOR® Associations.

IN CONTEXT

NAR's three-tier structure is a complicated assembly of 54 state and territorial associations and 1,341 local associations. This operating agreement was developed in a world that respected status and seniority. Today it is being judged in a different world of transparency and accountability. The varying perceptions of how the three-tier structure operates has resulted in parties placing the blame on NAR for perceived failures when often NAR has little, if any control over many activities. The reason is that the state and local associations are independent and separately incorporated companies with different charters, articles, and boards of directors. They are somewhat akin to a franchise, where only certain items are shared, such as branding, members, and ethical standards. As a result, many decisions fall under the purview of each organization and therefore many associations, as independent entities, can easily find themselves on opposite sides of the table.

For example, a local association negotiating with a vendor may differ from a nationally negotiated agreement. Disconnects like this between the three-tiers prompted Dale Stinton at the 2014 Midyear REALTOR® Conference to state that "The three-way agreement [between local, state, and national associations] is not written in the [NAR] constitution anywhere. It's an understanding, [but even] so let's deal with the three-way agreement and let's figure out what it means at all three levels." The key, Stinton said, is to "stop duplication at three levels."

“Like the Government, many non-profit associations have too much redundancy. Time to make some meaningful cuts.”

AUTHOR’S PERSPECTIVE

This structure is one of NAR’s biggest and most unique assets, providing huge benefits to NAR and its REALTOR® members. There are many benefits that can be derived from maximizing scale and volume, and NAR has done well by leveraging its position as the largest trade association in the world. But size can also be the enemy. The challenge is in separating the respective issues in order to identify where and when uniqueness requires local or tailored solutions. Too often customization is driven by politics and personal opinion. Remember that personal/company biases must be left at the door when trying to decide what is best for the association and the members being represented.

Danger Index

80.0

Probability

4.0

Timing

5.0

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
C3

OUT POSITIONED AS INDUSTRY SPOKESPERSON

The continued proliferation of voices and huge ad budgets challenge NAR's position as "The Voice of Real Estate."

IN CONTEXT

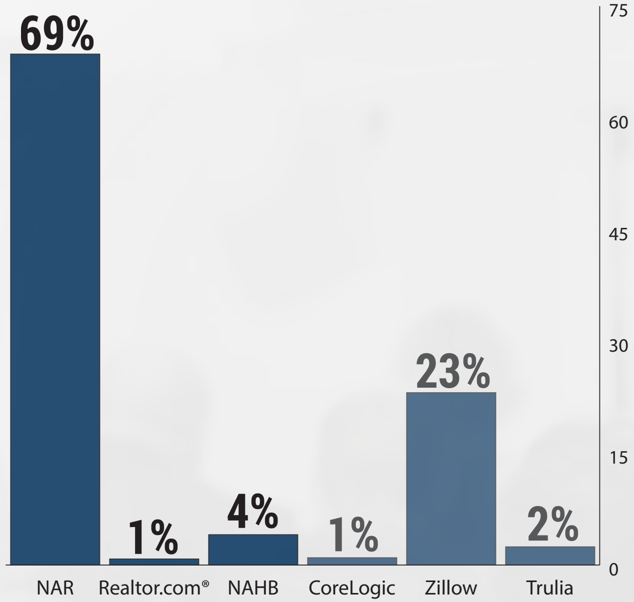
NAR announced that its 2015 Consumer Advertising Campaign—part of its $35 million annual advertising campaign—will, through 22,800 radio, TV, and digital spots, reach the consumer an average of 35 times with 3.9 billion impressions.

For decades NAR has prided itself in being "The Voice of Real Estate" for its members, America's homeowners, and the millions of people who aspire to one day own their own home. With that stature NAR has done an incredible job of becoming the leading advocate for homeownership and in creating huge recognition in the media. The monthly NAR Housing Report on Existing-Home Sales is always widely quoted, although in recent years it has shared the spotlight with the Case-Shiller Home Price Index and Zillow's Home Value Index.

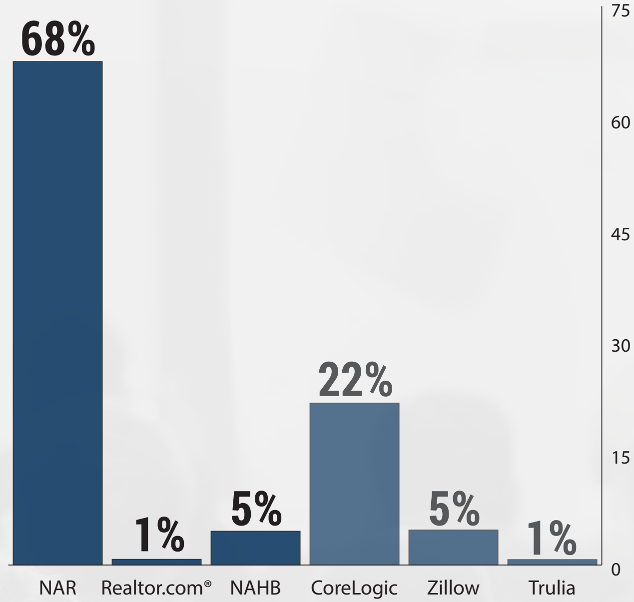
SHARE OF VOICE

These charts report the percent of visibility of different brands as they relate to homeownership and real estate data respectively as tracked by media monitoring firm, Cision, for January 2015.

HOMEOWNERSHIP



REAL ESTATE DATA



AUTHOR'S PERSPECTIVE

The real estate industry is populated by several strong voices, some providing similar housing and economic information and others building their brand. NAR, as a industry-wide advocacy organization, has a very unique and special cache that no other company can replicate—that is very valuable.

Danger Index

72.0

Probability

4.5

Timing

4.0

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 C4 MISSION CREEP

NAR expands beyond its core focus, which hinders its ability to respond to a broad base of threats.

IN CONTEXT

A gradual and unplanned shift in objectives often results in an unintentional long-term commitment that is not always beneficial. However, when an organization makes deliberate planned changes–to improve its position, market share, or services levels–that is widely considered a sound strategy. NAR, being the large organization it is, has during the last decade introduced many new initiatives such as:

- REALTORS® Property Resource
- Second Century Ventures
- Xceligent
- SentriLock
- Top Level Domains
- REALTORS® Federal Credit Union
- REALTOR® University
- HouseLogic
- RET Radio

AUTHOR'S PERSPECTIVE

It appears that trade associations for doctors, dentists, lawyers, and other professions have all fallen from grace in recent years, and it seems that their fall is not correlated to whether or not they are staying true to their core mission. The issue isn't about critiquing NAR on the success of its non-core activities especially since its performance venturing into unchartered waters has been no less successful than that of many entrepreneurial companies. Many large companies are able to multi-task and successfully manage different initiatives. So the debate is whether or not diversification by an association is a dilution of resources or a progressive strategy. The industry appears divided on that.

Danger Index

64.0

Probability

4.0

Timing

4.0

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 C5

THE CATCH-22 TECH QUANDARY

Major technology initiatives by NAR succumb to political headwinds.

IN CONTEXT

REALTORS® Information Network (RIN), Realtor.com, and REALTORS® Property Resource (RPR) are examples of initiatives that have had to battle political headwinds. RPR, a free membership service, was launched in 2009 and has, to date, received funds totaling $98.9 million; by the end of 2016 its funding is expected to exceed $142.7 million.

Redfin is similar to RPR. It was founded in 2004, launched in 2006, and went through a fifth funding round of $70.9 million in 2014 (bringing the total funding to $166.6 million). Although the two companies have a different charter, both are young tech-based upstarts in the real estate space.

Redfin has grabbed the industry's imagination and is often associated with innovation, best website, best mobile app, etc., while RPR has received criticism and boycotts. Both have yet to turn a profit, but Redfin is widely expected to become a billion dollar IPO within the next 12 months. NAR does not have as many options as a private company and cannot disinvest from their investments since many of their services are designed as free member benefits.

There seems to be a perception that REALTOR® entities should not be engaged in producing technology initiatives, whether competitive or not, and that REALTORS® will not automatically purchase technology from associations just to demonstrate their loyalty to the cause. NAR has had to constantly overcome REALTOR® objections, making success even more complicated than it would have been had it been a non-NAR initiative.

AUTHOR'S PERSPECTIVE

NAR has been saddled with the reputation that it hasn't been good at developing technology. At the same time it is criticized for not being aggressive enough in competing with tech companies in the space. What a catch-22 dilemma!

"REALTOR® Associations need to be run like a business. Are we willing to make the hard decisions to make this happen?"

Danger Index

64.0

Probability

4.0

Timing

4.0

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 C6 THE QUALITY / QUANTITY CHALLENGE

The discord caused by trying to be both an association for everyone and an association only for the best reaches a breakpoint.

"Too many agents aren't worthy of the REALTOR® brand."

IN CONTEXT

NAR is a membership-driven, dues-based organization. Therefore its revenue stream is primarily driven by size, which results in the majority of the decisions being based on the masses. The leadership, both on the national and regional (state and local) levels, is often divided when having to take decisions. Do they serve the best of the best and thereby often focus on a small group of members, or do they support the wishes of the majority. These two membership segments have very different needs and wants that are almost always impossible to satisfy at the same time.

NAR Membership Milestones

1911	3,000
1913	6,000
1920	10,000
1944	20,000
1948	40,000
1957	60,000
1965	80,000
1972	100,000
1975	250,000
1977	500,000
1986	750,000
2004	1,000,000
2005	1,250,000

Source:
National Association of REALTORS®

AUTHOR'S PERSPECTIVE

It is widely acknowledged that NAR's membership numbers are very cyclical and strongly influenced by the condition of the housing market. Despite that fact, its membership growth over the past century has been nothing short of incredible.

Many REALTOR® Association structures are built around the principle of headcount, thereby forcing many key decisions to be based on quantity rather than quality. And that's okay. Not everything always has to be equal or fair to everyone. Different services for different members at different times is a completely acceptable business practice.

The time has come to resolve the decades-long confusion of whether NAR should be a membership-driven organization or an association focused on quality, professional membership.

Danger Index

60.0

Probability

4.0

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 C7

INSUFFICIENT NEW BLOOD

All levels of the REALTOR® Association world—national, state, and local—struggle to attract young recruits.

"Youth is a gift the industry is yet to receive."

IN CONTEXT

Real estate sales has rarely been seen as a first choice career, which has resulted in the industry being populated by people that enter at a latter stage in their career, for a variety of different reasons: easy entry with minimum requirements, the perception of easy money, etc. Due to the fact that there is no standard retirement age, brokers and agents remain in the industry much longer than in most other occupations. The combination of these two facts has resulted in the real estate industry developing a very mature demographic.

Many feel NAR is the best positioned to package real estate sales as a career for a new generation of young people.

AGE OF REALTORS® (2003 - 2014)

	2003	2009	2014
Under 30 years	5%	4%	3%
30 - 34 years	6%	4%	4%
35 - 39 years	9%	7%	5%
40 - 44 years	13%	9%	7%
45 - 49 years	12%	12%	10%
50 - 54 years	16%	16%	16%
55 - 59 years	15%	15%	16%
60 - 64 years	12%	15%	16%
65+ years	12%	17%	24%
Median age	**51**	**54**	**56**

Source:
National Association of REALTORS®

AUTHOR'S PERSPECTIVE

NAR's membership profile has gradually aged over the last decade from 51 (in 2003) to 56 (in 2014). Furthermore, as can be seen from the table, the under 40 group has declined from 20% (in 2003) to 12% (in 2014) while the over 60 group has risen from 24% (in 2003) to 40% (in 2014).

Attracting the next generation of REALTORS® is necessary to assure that the real estate industry retains the vitality necessary to innovate and grow. Promoting real estate as a first-career choice is one way to reverse the unsettling demographic trends evident during the past several years.

Danger Index

56.0

Probability

4.0

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.

DANGER C8 SHORTAGE OF LEADERSHIP TALENT

There simply isn't a large pool of talented, dynamic, knowledgeable, young executives available to lead Organized Real Estate (ORE).

"A one-year term for President is too short to get anything done. We don't need a new president every year."

IN CONTEXT

Since the Digital Revolution and the shift to the information age, the profile of the leaders needed in ORE has changed significantly. The skills and attitude now required in a take-charge CEO are those of a profit-driven, service-competitive, Internet-leveraging individual. The problem is that ORE has been far too comfortable with the status quo; it has been afraid to change, leaving it with many aging leaders that are finding themselves overwhelmed and out of touch. Compounding this problem is the widespread failure of the industry, from NAR down to the smallest association or brokerage company, to adequately plan for this transition, a transition that it has seen coming—and purposely avoided—for decades.