We hope you enjoy the following chapter from *Game Plan* by Ian Morris of Market Leader, Inc. and Steve Murray of REAL Trends, Inc.

Please contact a Market Leader industry expert at **1-866-840-1685** to better understand what these trends will mean for your business!
In talking about the disruptive forces of competition, technology, and demographics, it’s essential to note that, for the most part, our industry has done an excellent job of absorbing rapid change. Of course, the bull market for housing had a lot to do with that. When housing prices double and concurrently volume increases substantially, the rapidly increasing pie enables those who execute effectively to tolerate quite a bit of adversity.

To quantify this, just look at the long-term average annual amount of sales commissions, which had held steady at around $40 billion per year. At the height of the bull market, this number climbed to nearly $80 billion per year. Then came the great recession, and downturn in housing, which brought commissions back down, below the levels of ten years earlier.

Very few industries can survive that kind of cratering without an extremely high level of attrition. In real estate, while many professionals washed out, many others streamed in after being laid off from jobs in other industries. As a result, while the pie got cut in half, the number of people trying to make a living in real estate stayed near record levels.

And that’s where we find ourselves today. We’ve largely adjusted to disruptive new business models which have now become a part of our reality. We’re still dealing with the Internet and incorporating innovate
new ways of doing business into our models. At the same time, we are dealing with significant changes in the housing consumer and their needs. And of course we are doing all of this in the backdrop of a slow housing market where we all must work much harder to earn the same commissions.

It’s an environment that demands all of our attention and responsiveness. To succeed we need to have a keen understanding of how our environment will continue to evolve and what it will take to win in the years ahead. That’s why we’ve identified the ten trends that we believe that real estate industry professionals will need to watch carefully. No matter which strategy or business model you pursue, understanding these ten trends and what they will mean for your business will put you ahead of the game.

◆ The Ten Trends That Will Drive the Next Five Years:

1. **A Slow Recovery in Housing Sales and Prices**
2. **Changing Consumer Demographics**
3. **Pressure on Commission Levels**
4. **The Continued Advance of New Business Models and Industry Segmentation**
5. **The Growing Importance of Lead Generation**
6. **The Use of Integrated Technology Platforms**
7. **The Evolution of How Consumers will Select Real Estate Professionals**
8. **The Importance of Leadership**
9. **The Emergence of Real Estate Teams**
10. **A Stiffening Regulatory Environment**
1. A Slow Recovery in Housing Sales and Prices

Currently, the overhang in inventory combined with the lower than expected growth of households is delaying the time when the housing market will return to health. Shadow inventory is another major factor in restraining prices. This refers to the historically high percentage of homes whose owners are delinquent on their mortgage payments. The houses are not yet in foreclosure, but have the potential to come onto the market, and at a discounted price.

Despite all of these factors, over the next three to five years housing sales are expected to recover from their lows of the third and fourth quarter of 2010. Annualized existing home sales are projected to be 5.1 to 5.2 million in 2011 with the potential for a small surprise on the upside of that level. New home sales are projected to come in around 400,000 to 450,000 for 2011, again with some potential for some upside improvement.

For 2012 through 2015, projections from NAR, Fannie Mae and others indicate that sales will show steady growth (by historical standards) towards 5.7 to 5.9 million existing home sales and 650,000 to 750,000 new home sales at the end of the next five years.

These projections are based on a steady lowering of unemployment, the continuation of low mortgage interest rates and a return to normal levels of consumer confidence. Many believe that due to fiscal challenges at the state and federal level, unemployment will remain higher than normal for the next few years and that interest rates will climb as state and federal governments continue to borrow record amounts to fund deficits. Both of these scenarios would generally cause the economy to grow more slowly than normal after a recession and limit the growth in housing sales.

The growth of the economy will have a great impact on household formation and immigration. Both of these key factors fell during the recession and, should growth be slower than expected, housing sales, particularly to first-time homebuyers, will be sluggish. The other factor that will impact housing sales is the 71 percent of new households that are expected to be minorities—the very groups who have seen
shrinking homeownership rates over the past 3-4 years and are the most impacted by the foreclosure crisis. The ability for these families to purchase housing given tightened lending standards and lack of income growth may reduce their homeownership rates in the short term even further.

Prices of homes for 2011 are projected to be soft in many markets across the country due to the continued overhang of inventory. Current inventories are estimated between 3.8 and 4.5 million homes with an additional 1.5 to 2.5 million distressed homes in some stage of delinquency or foreclosure. At this time estimates of the potential of this shadow inventory vary greatly. Nonetheless, for 2011 and 2012 there’s likely to be an overhang of inventory that will keep a lid on prices in most markets and in most price ranges.

Given the small increases in unit sales and neutral-to-small increases in home prices expected for the next two to three years, the industry will show small and steady increases, but no return to robust growth is likely in the near to medium term. There will be markets where inventories come back into balance more quickly, and where employment and incomes rise faster resulting in larger gains than are the norm nationally.

In this type of market, leaders will want to be extremely cautious and thoughtful about how they invest in their business. In an environment where the pie is not growing significantly, you have to look critically at strategies to grow market share. Historically, the solution has been to recruit more real estate professionals. Today, it’s uncertain how effective that strategy is going to be. Because real estate professionals have the economic power, the margin brokers can make on each incremental Realtor® is not very good.

As a result, success in this market will require a coherent and focused strategy, and the conscientious deployment of resources on the professionals and consumers you wish to attract, and the competitive advantages you will need to win their business.
2. Changing Consumer Demographics

Generational and cultural segments will matter more in the future than they have in the past. There are now four generations of home buyers and sellers in the market: The Traditionals (>66 years of age), the Boomers (47-65 years), the Generation X (35-47 years) and the Millennials (<34). This represents the first time in the modern age where there are four distinct generational groups engaged in the purchase and sale of homes. As Pat Riley, president of Allen Tate Companies notes,

We have a unique situation where we are now serving four distinct generations, each with their own housing needs and requirements and each selling or purchasing in different ways. One of our great challenges will be to ensure that we have a diverse group of sales professionals who mirror these demographics.

That’s because there is little crossover of generations during the agent selection process. When housing consumers choose a real estate professional they tend to choose someone of approximately the same age. For instance, rarely do Boomer sales professionals serve Gen X or Millennial housing consumers.

The same is true of ethnicity. That’s important because minorities, many of them immigrants, are expected to make up 71 percent of all new households over the next ten years.

Real estate professionals need to keep a watchful eye on the buying preferences of these demographic groups and broker/owners need to be sure that they are building a team of professionals who are most apt to reach their target consumers. Why develop a sales force with expertise in suburban subdivisions, if you’re in a market where most people want a condo where they can live, work, play and shop—all in the same neighborhood?

Here’s a brief overview of generational characteristics, with the caveat that, like any generalization, these are subject to a great variety of
individual exceptions.

**Millennials** will make up the majority of the first-time home buyers in the next five years. They tend to marry later, with the possible exception of the minority or immigrant sub-segments of this group. Rather than suburban single-family detached residences, a large share of this generation will want lofts, townhomes, apartments and other low maintenance styles of housing. They will make the shift to larger housing once they begin to have families and, at least among some minority and immigrant populations, the average size of the family is larger than Non-Hispanic Caucasian households.

**Generation X (Gen X)** is a mixed group. The older members of this generation have likely already purchased their first home and many have traded up as they have started their families. Generally, they prefer more suburban neighborhoods as they seek schools and other amenities that support the family. Gen X homeowners were hit hard by the downturn in housing due to the timing of when they purchased their first homes and where prices were during this period. Thus, their ability to “move-up” may be negatively impacted for several years.

**Baby Boomers**—at least the older ones—are beginning to plan for retirement. This group accounts for a large share of the purchase of second homes and retirement residences. Their children (mainly the aforementioned Millennials and Gen Xers) have grown and moved away, thus leaving Boomers with the need for more efficient living quarters. This generation has also been hit hard by the downturn in housing and may delay the move to smaller quarters due to little-to-negative equity in their current homes.

**Traditionals** are in their retirement years and, like the oldest of the Boomers, are moving into smaller and more efficient living quarters. The oldest of the Traditionals are also seeking maintenance-free living arrangements and a growing segment is seeking assisted living quarters. This generation remains important purchasers of second homes as well.

The Millennials and Gen Xers will account for the majority of home purchases over the next 3-5 years. On a volume basis, the Boomers
will likely still account for the largest percentage due to their current holdings and the size the generation itself.

Currently, the average real estate sales person is older and of different ethnicity than the majority of homebuyers that are expected to enter the market in the next five years. Brokers should think carefully about recruiting more young people, and people who are most connected to the consumers that they wish to serve. Similarly, agents who come from different countries, speak different languages, and/or represent growing minority groups may prove to offer a significant competitive advantage to forward thinking brokerages in many communities.

3. Pressure on Commission Levels

The average national residential commission rate fell in a virtual straight line from 1991 to 2005, falling from 6.1 percent to 5.02 percent. With the downturn in the market the average rate increased back to 5.36 percent as of the end of 2009. 2010 should show a similar result.

Numerous studies show that it was competition among sales professionals for relatively scarce listings that was the main culprit for falling commissions—not the Internet. The average commission rate fell more prior to the entry of the Internet and public listing portals than it did afterwards. And the rate increased after 2005 even with further developments and greater use of the Internet by housing consumers.

Sales professionals reported in various focus groups that they were willing to grant discounts on their charges in order to win business during the period of robust growth. This is not surprising, given that housing prices (and therefore total commissions) grew at a substantial rate, more than making up for reductions in the commission rate itself.

Over the next 3-5 years the market will return to balance and the competition for listings will once again be fierce. Additionally, we will see growth in the number of brokerage firms using newer business models (100 percent commission, capped company dollar and virtual...
brokerages) that have lower incentives to drive a commission standard with their firms. These factors will both lead to downward pressure on the commission rate.

In the past, most of the downward pressure has been felt on the listing side of the transaction. Today, pressure on the buy side of transactions is beginning to build and will continue to do so for two reasons. First, there are firms, such as ZipRealty, Redfin and others, whose offers of service include a commission rebate on the purchase side. Second, an emerging practice among buyers is to deal directly with listing professionals, removing a buy side professional from the transaction. These homebuyers request a rebate of some portion of the commission that would normally be allocated to the buyer’s sales professional.

In order to make up for declining commission levels, brokers and sales professionals will need to manage their costs and be creative in seeking out steady sources of transaction volume. We have already seen this trend at work during this downturn as many professionals have built competencies in working foreclosures or short sales that they would never have considered spending time on before the market turned.

4. The Continued Advance of New Business Models and Industry Segmentation

For the past thirty years, each succeeding business model has generally raised the commission percentage payable to the sales professional and lowered the commission percentage retained by the brokerage. To put it another way, sales professionals, over time, have sought, and will continue to seek, the most profitable environments in which to operate their personal businesses. For example, big producers can afford the high desk fees charged by 100% commission shops, because they expect to recoup the outlay in short order by maintaining the commissions they earn. The majority of Realtors® however don’t have frequent or large enough sales to take on those higher desk fees. Instead, many have moved to Capped Commission brokers where the overhead is lower, and in the future, more of these agents will consider Virtual Brokerages where they are lower still.
Traditional brokerages have evolved and built flexible models to retain their sales professionals. While this worked well for many in the past, the downside is by trying to be everything to everyone, the brokerage can easily find itself in a situation where its value proposition is no longer the most attractive to any of the sales professionals that it hopes to target. Industry economics will pressure brokerage firms to select the business model that is right for them and to focus their energies and limited resources on the professionals that will fit that model.

Let’s look at this idea in a bit more detail. When sales volumes were soaring and the ability of lower cost models to offer competitive support programs was limited or of little interest to most sales professionals, most brokerage firms and sales professionals didn’t have to choose one model over another. They adapted on a case-by-case basis to meet new competition while carrying the legacy costs of their existing business model.

Given the expectation that sales volumes will not recover to the double digit growth rates of the 1985-2005 period, the new lower-cost models are causing everyone in the industry to reexamine the tug-of-war between what services brokerages can deliver and what sales professionals value in turn from their brokerage firm.

It’s not just brokers who must determine what value proposition they are offering to sales professionals—who they see and treat like customers. Sales professionals also need to sort through the various brokerage offerings carefully to find the one that best fits their needs.

Will these choices always be rational and based on an absolute “dollars-and-cents” basis? Of course not, any more than consumers of all kinds purchase their goods and services outside real estate. Sales professionals will make their choice of brokerage based on business potential, commission and fee programs, quality of the firm and its reputation, friends they may have within a firm, and the support package offered by the firm.

In the future, this will put enormous pressure on brokerage firms to build brokerage business models that offer the right packages of
support services at prices and terms that allow them to reasonably grow, and make a return from the business. It means that a firm can’t be a full-service brokerage, and have the lowest cost offer for sales professionals. It also means that brokerage firms can’t be the lowest-cost provider, and offer the fullest range of services for sales professionals.

In short, brokerage firms can’t be all things to all sales professionals, and thrive.

5. The Growing Importance of Lead Generation

While our industry’s professional-centric focus will continue over the next five years, a new focus of great importance is also emerging and will play a big role in our future. That focus is on leads, and the tools needed to close them.

While leads have always been important, the growth of technology has accelerated their role as a currency in today’s real estate industry. Currently, virtually every national network is engaged in some lead generation activities. Search Engine Optimization (SEO), Search Engine Marketing (SEM), the integration of IDX sites, and the use of advanced data mining and database marketing are just a few examples of early investments made by agents, brokerage firms, and franchises to build their competency in this important area. As such, leads are emerging as a new currency for the industry.

Of course, as we have all learned, the lead is not even half the battle. The majority of sales professionals (and in fact most small business people) have little training in the cultivation of leads. As a result, contact management, lead cultivation, and customer relationship management systems can and will play a huge role in determining which agents and companies are most successful. After all, lead generation is a numbers game, and only easy-to-use lead cultivation systems will enable professionals to build and manage the thousands of relationships they will need to manage in order to become a top performer. All of which brings us to our next trend.
6. The Use of Integrated Technology Platforms

The real estate industry has long suffered from the lack of integrated systems for handling both the property data and consumer data pertaining to a real estate transaction and the applications to make them work seamlessly.

For too long there’s been a mindset of thinking, “Technology is critical to our future. Therefore, we’re going to build a proprietary system that will be a competitive advantage for us.” This approach has not been a good use of precious industry capital as brokerages around the country find themselves trying to maintain and integrate legacy systems, at great cost, both in terms of money and time-to-market.

At the same time, recent announcements from leading franchise networks demonstrate that the ante will continue to be raised in terms of technology, and what professionals will expect from their firm or franchise. As expectations continue to increase, most of the innovative, but small and under-capitalized technology firms which play a big role in our space, will be unable to keep up, especially as brokerage firms come to expect more in terms of critical issues like the security of customer data, privacy, and business continuity.

As a result, we expect that, over time, more business will migrate to cloud-based offerings from larger providers that can integrate effectively with other offerings, thereby relieving brokerages of the burden of building and maintaining costly proprietary systems. These firms – those that choose to invest in integrated systems that can be updated rapidly – will likely build a cost advantage while reducing the time it takes them to bring to market new innovative features.

7. The Evolution of How Consumers will Select Real Estate Professionals

Consumers are already using online sources of information in addition to traditional ones when they think about choosing a Realtor®. Of course social media has to be front-and-center in this discussion. This is true simply because many conversations that once happened in
person or over the phone are now taking place online.

We could easily restate this trend as follows: “Referrals from friends and family will continue to be important.” What’s new is that those referrals are happening on Facebook, Twitter, Yelp, and other websites. Leading Realtors® have already learned this, and this trend will certainly continue.

Consumers are also locating and choosing sales professionals and brokerage firms based on information they find on real estate portals created by consumer housing related firms such as banks, membership organizations, and even retail firms.

For example, both USAA and Bank of America have set up, or are in the process of setting up, fully functional real estate portals. Customers who use the main websites of these two firms can visit the real estate section to search listings and research sales professionals’ experience and qualifications.

In addition to these new channels, there are a variety of efforts to place some form of sales professional rankings online. Firms such as Trulia and Zillow are both experimenting with these new consumer-facing tools. Some Realtor® associations are also doing the same. There are also sites such as Angie’s List and Yelp, which have more generic service ratings and a growing number of reviews of real estate sales professionals as well. All of these sites are eager to offer these services both to meet perceived consumer demand as well as to increase their prominence with search engines which often promote just this type of content in their results.

So while the majority of housing consumers are likely to continue to reach out to friends and associates to locate and select a sales professional, the way in which they do this will continue to transition online, and specifically to social media sites. As a result, growth oriented agents, and particularly those focused on serving Millennials and Gen Xers, will need to be sure to build their reputations and their networks online.
8. The Importance of Leadership

What factors have the greatest effect on the performance of brokerage firms over long periods of time? Research shows that it is not size, location, brand or business model. While these factors are important, the one that matters most is the capability, intelligence and work ethic of the leader of a brokerage firm.

It’s not that hard to understand why. These are tumultuous times. Business leaders have had to deal with three disruptive factors that are subjecting the industry to constant change. That’s where leaders prove their worth. Leadership is about making tough choices, and we know that in the next five years, the all-things-to-all-people strategy is simply not going to work.

Leaders will need to decide what business strategy they want to follow, and define a Game Plan to reach their strategic goals. This involves telling your staff and sales professionals what your brand stands for and who you are culturally, even when those decisions involve short term pain.

The day-to-day responsibilities of brokers and sales managers will vary depending on the business model of a brokerage firm. For full-service brokerage firms, sales managers must be good at recruiting, coaching, mentoring, supervising, reviewing transactions, and putting deals together. They must also be familiar with how to work with in-house loan officers and settlement service providers. For some high commission concept and capped company commission firms, the roles are not quite as extensive.

Unfortunately, few brokerage firms, regardless of business model or size, are investing any appreciable amounts into the development of future leadership for sales or company management. Today the average age of the leadership team at all levels, for most brokerage firms, is well above 60 years. Clearly it’s time to start developing new talent with the background, skills, and temperament needed to make tough decisions and hold people, including themselves, accountable.
9. The Emergence of Real Estate Teams

We’ve already talked extensively about the massive shift in our industry from a broker-centric to a professional-centric model. You might say that the next logical step has been a refinement of that model: How sales professionals can effectively take the professional-centric model to the next level. In other words, how they ‘get big’ and ramp up their income by delegating specialized tasks to other team members. We are seeing more and more of this as top professionals invest in lead generation, and then build out their teams to work those leads.

Interestingly, these teams offer a compelling value proposition to other sales professionals as well. Many sales professionals are all too eager to forgo the costs of investing in their own marketing, prospecting, and brand building activities, when they can make a good living working with more customers on a high performing team.

The keys to this model are process, specialization, and accountability as team leaders define specific tasks for each team member, and hold agents and staff accountable to the successful execution of these tasks.

With the advance of lead generation and CRM systems, there are no known limits on real estate teams. The largest teams drive as much volume as brokerage firms ranked on the REAL Trends 500 report. There are hundreds of teams in North America, some with two people and a few with over 20. Their total numbers are growing at this time and we expect they will continue to do so. The economics are compelling regardless of the brokerage firm or geography, and we expect that many agents and brokerage firms alike can learn a great deal from the strategies being pursued by these business leaders.

10. A Stiffening Regulatory Environment

There’s no question that, since the housing crash, there’s been a rush to point fingers at the causes. In this climate, our legislators and rule-makers have been busy creating new regulations that purport to ‘prevent’ an economic disruption of this magnitude in the future.
We’re not going to weigh in on the effectiveness of much of this new sausage-making, but many new laws and regulations are on the books at all levels of government, and there’s much more to come.

Along with more regulation, because of the straitened circumstances experienced by governments at all levels, we see great potential for higher taxation of homeownership. This includes changes in homeownership supports, such as, a potential elimination or reduction in the mortgage interest deduction, as well as, the prospect of rising property taxes.

Additionally, areas such as RESPA, Truth in Lending, energy audits and other legal requirements will receive far more scrutiny than in the past.

You think residential real estate transactions are already abundantly complex? There’s more to come. Along with heightened scrutiny from federal and state regulatory bodies in the area of appraisals, lending, fair housing and inspections, there’s a high likelihood of new home energy–related audits, higher transfer fees and taxes, and more scrutiny from housing consumers.

One large issue is the fate of GSEs like Fannie Mae and Freddie Mac. As of this writing, the future of these mortgage giants is uncertain. What appears certain is that they won’t be in a position to provide the kind of ready-made secondary market for residential real estate loans they had in the past. This may mean higher-priced residential mortgages with far more stringent requirements for borrowers.

The Dodd-Frank Wall Street Reform and Consumer Protection Act passed in 2010 also have several provisions that may tighten lending further. One other area that will impact residential real estate sales professionals (and brokerage firms) will be increased privacy regulations that impact how, when and where information may be or must be shared, stored and protected. Already some national banks are rearranging their relationships with residential brokerage firms under joint ventures and marketing alliances due to the new regulatory requirements. Most of these changes will not be favorable to residential brokerage firms.
There are no indications at this time that there will be heightened regulation of real estate sales professionals—except for increased continuing education requirements.

Stay tuned, and be sure to make your voice heard by our elected officials both privately and through our industry’s associations.
For more information on how to use industry trends to grow your business, contact a Market Leader industry expert at 1-866-840-1685.

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