THE RED DOT

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Next Generation Brokerage

The Contemporary Agentcentric Model

Brokerage Edition

Observe. Orient. Decide.

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Observe.

INTRODUCTION

It might be said that no industry in North America is as susceptible to disruption as real estate is. Everywhere you look, there is yet another technology company raising huge financing rounds at unicorn valuations claiming to disrupt the industry.

And yet, one of the most disruptive forces in real estate in recent years has gone mostly unnoticed except by a few in the trenches in real estate: a new breed of brokerages who have leveraged technology to offer extremely low-cost brokerage services to agents and agent teams. Because they offer the agent 100% of the commission with no split paid to the brokerage, this group of brokerages are often referred to as "100% shops" in a faintly derogatory fashion by traditional brokers.

Their ranks include companies like HomeSmart, Realty One Group, Charles Rutenberg, Fathom Realty, and dozens of other smaller companies that are now popping up all across the country.

They are among the fastest growing in the industry and are challenging not just the stalwarts of traditional brokerage such as Realogy and HomeServices of America, but also the former-upstarts-who-have-joined-the-mainstream companies like Re/Max and Keller Williams.

Amazingly, these companies are poorly understood by outsiders, even by longtime brokers and agents. Their low-cost dominates perception and there is very little understanding of how these companies work, or *why* they work. Focusing only on price and cost means you miss the big picture.

Accordingly, rather than calling them "low-cost" or "100%", I will refer to these companies as Next Generation Brokerages ("NGBs"). They practice an agentcentric model of brokerage that is built around efficiency, productivity, and centralization; that practice is enabled by changes in technology, which drives massive changes in the structure of the real estate industry.

While we at 7DS Associates believe that in the long-run, The Platform and W2-based brokerages such as Redfin and Opendoor will rule the industry, in the near-term, the Next Generation Brokerage is taking over.

This Red Dot is about them, why they work, how they work, and how the industry should prepare for their dominance.

I have spoken to a number of people in researching this report. I would like to thank Steve Murray of Real Trends, Wendy Forsythe of HomeSmart, Sam Khorramian of Big Block Realty, Sam DeBord of Coldwell Banker Danforth, and Giuseppe "JP" Piccinini of JP & Associates REALTORS for their time and insights. This report is much richer for your sharing your experiences and insights.

Additionally, this report is unique in that it has a co-author: Sunny Lake Hahn, who is not only my wife but is also the Partner of Brokerage Consulting practice at 7DS Associates. Her experience as a former managing broker and as a real estate agent, her work with brokers and agents across the country, and her native wisdom and intelligence have all been absolutely invaluable in decoding some of the more intricate details of how and why these Next Generation Brokerages work in the real world.

It should also be said that she is my sail, my anchor and my sun, moon, and stars. I could not imagine navigating these waters of life without her.

Robert Hahn
September 2018

EXECUTIVE SUMMARY: BROKERAGE

There are numerous reasons why traditional brokerage is dying, but at the top of the list (at least in the short and medium terms) is the emergence of the Next Generation Brokerage ("NGB" hereafter). They practice a contemporary, technology-powered form of agentcentric brokerage that is a perfect fit for our time. Low cost is merely the result of that evolution.

The How

The NGB has taken Keller Williams and its culture of agentcentric brokerage to the next level. In fact, what the NGBs have hit upon is the logical endpoint of the agentcentric model where the brokerage more or less disappears as an organic unified entity and becomes something more like a loose confederation of independent businesses.

Turns out, the ultimate in agentcentric is the individual agent operating her business, whether solo or in a team, as she sees fit.

Fees, Not Splits

Fundamentally, the NGB generates revenues from fees rather than from commission splits. This is perhaps *the* distinguishing feature between an NGB and a traditional brokerage.

Because the NGB does not take a piece of the commission, one interesting result is that the NGB does not care about the price of the homes bought and sold by its agents.

Please note that traditional brokerages also charge a number of fees, most famously the desk fee of Re/Max.

However, we regard these fees as more of a *defensive* move the brokerage was forced to take because of pressure on commission splits, rather than as a core feature of the business model.

It's Not the Money (But It's the Money)

All of the NGB operators say that they don't actually compete on price. It's not the money, they say, but *value*.

The refrain is, "We're full-service, but without broker splits."

And yet… the 100% commission is at the heart of the NGB's success in more than one way.

For the agent, it's never about the money, until it's about the money.

Same, Or Higher, Margins

Steve Murray of Real Trends said that once the NGB hits scale – between 300 and 400 agents – their net profit margin is closer to **10-12%** rather than the 3-4% of traditional brokerages.

The implication is that the NGB is generating less in revenues, but far more in profits.

So how do they achieve that level of efficiency?

Low Overhead

The first requirement to be an NGB is to reduce your overhead expenses to the bare minimum. Operational efficiency, discipline, and as one CEO of an NGB said, "lack of ego" are critical for success.

Occupancy

The common thread amongst all successful NGBs I have looked at shows that they operate with very small physical footprints.

In comparison, the NGB operators *routinely* discuss having 50 sq. ft. *or less* per person. They run comparatively large brokerages out of small physical spaces. They're designed to do so.

Furthermore, the NGB is financially engineered so as to minimize occupancy costs. HomeSmart and its franchisees, for example, do have physical offices but the HomeSmart model calls for renting out private desks and offices to agents, with the rental income covering the occupancy costs in full.

The poster child for reducing occupancy costs has to be eXp Realty, which bills itself as a "virtual brokerage.

Without a physical office, except for those required by law which are not real estate offices as we might understand them, eXp reported that its agent count was 11,856 at the end of Q2/2018.

Payroll

Compared to traditional brokerages with their layers of management and staff, the NGB operates with a skeleton crew.

For example, traditional brokerages will almost always have a "managing broker" who runs the day to day operations of an office.

Instead of a managing broker who runs the day to day operations of an office, the NGB has a team of licensed brokers in a centralized location, often backed up by teams of staff members who specialize in one or more areas of core operations from recruiting to contract review. By centralizing brokerage functions, the NGB brokerage teams can handle a far larger volume of transactions, contracts, and advising and supporting agents than traditional managing brokers can.

In this and in other ways, the NGB runs a very lean operation from a staffing standpoint compared to traditional brokerages. One CEO of an NGB told me that he runs a brokerage with over 1,000 agents with a staff of 12.

Flexibility

One unique practice of the NGB I have found is that they avoid signing long term leases or long-term contracts.

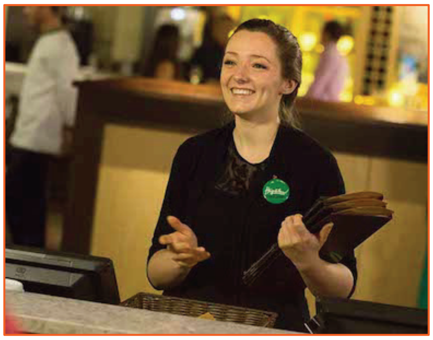
Flexibility is of paramount importance to an NGB, because they do not want to be locked in to overhead costs they cannot adjust relatively quickly if the business starts to drop.

Leverage Technology

This level of efficiency is impossible without technology. In fact, changes in technology are what drove and continue to drive the emergence of and growth of NGBs.

However, it is important to make a sharp distinction between the *kinds* of technologies that a brokerage needs to have. Wendy Forsythe, COO of HomeSmart, called them "front of house" and "back of house" technologies, borrowing from the restaurant industry.

Front of House



The "front of house" is technology that is visible to agents and to their clients. Marketing, CRM, websites, etc. make up most of this technology.

Most brokerages pay a great deal of attention to this kind of technology for a simple reason: **recruiting**.

Traditional brokerages and franchises sometimes spend enormous amounts of time, energy and money to develop and offer these front of house technologies.

Realogy, for example, acquired ZipRealty in 2014 for $166 million in large part to get the Zap integrated technology platform. Re/Max recently acquired booj, a real estate software company based in Denver. Keller Williams also made news when Gary Keller recently announced that KW was no longer a real estate company, but a technology company. It has rolled out a number of initiatives including Kelle, a virtual digital assistant, and the Keller Cloud, which KW calls "a single platform to run your entire business."

All of these are front of house technologies designed for agents to be more productive and more efficient. They are an important component of a traditional brokerage's recruiting and retention efforts.

However, these efforts at providing technology solutions have not yet paid off for any traditional brokerage who has really tried it.

Front of House on the Back Burner

To be sure, the NGB offers these front of house technologies as well. It's just that the focus and the emphasis is not actually on these tools.

For example, HomeSmart offers a whole "Technology Suite of Tools. Realty One Group offers a whole suite of products from a wide variety of vendor partners.

So, it isn't as if the NGB doesn't offer technology platforms. However, dig beneath the surface and what emerges is a fascinating departure from the traditional mindset if not the model.

The NGBs recognize that agents are going to use what works for them. There is no way to force an agent to use any of the tools offered.

Focusing on the front of house technologies, therefore, is not a top priority. The front of house technology provided by the NGB is more of a "baseline" offering, like clean sheets in a hotel.

The Vendors Are Better, Cheaper, Faster

The reality is that the technology vendors in the real estate space are just better, cheaper and faster than the in-house solutions at most brokerages not named Redfin.

There are technology companies that sell a variety of products and services to brokers, teams and agents across the cost spectrum. Almost all of them are better, faster, and cheaper than the brokerage's own in-house solution.

Back of House

The "back of house" is where the nitty gritty of the operations happen: accounting, recordkeeping, task management, etc. Most of this technology is rarely seen by the agent and is not consumer-facing. Back of house technology is aimed at making the brokerage *staff*, rather than the agent, more productive. And it is essential to how the NGB operates.

Interdepartmental communications, document storage and sharing, centralized calendars, common financial accounting and reporting platforms – these are the mundane tools that allow the NGB to drive efficiency and productivity at the corporate level.

This is where they invest, because that investment yields efficiency and productivity from the paid employee staff.

In contrast, in traditional brokerages, the back of house technology is an afterthought. They focus far more on cost to the brokerage rather than on ease of use for the staff or staff efficiency and productivity.

Specialization

Technology alone, however, does not create the level of productivity and efficiency to drive profits on such thin margins. Specialization is the other major distinguishing operational feature of an NGB.

The Traditional Managing Broker

As we touched on above, traditional brokerages have a managing broker for each office. The managing broker has ultimate day to day responsibility for the overall operations of that office. That also means, however, that the managing broker has to get involved with every single aspect of operations.

Brokers are required to be recruiters, trainers (even if there is little to no differentiation), counselors, bartenders, coaches, hostage negotiators, deal doctors, and managers.

On the other hand, the performance metrics of managing brokers are often tied directly to recruiting and retention.

But on the third hand, the position of managing broker is often one *required* by state licensing authorities.

Recruiting and retention are important for growth, and the managing broker has to run the day to day operations, but he must fulfill the legal and regulatory requirements.

Yet, this is the way that business has been done for decades, and it remains the way that business is done today for the vast majority of brokerages.

A Note on Training

Because agents only see value up to a point. Most agents are not willing to pay for in-house training; they have come to expect it as part of the package that they pay for through their commission splits.

What that means in practical terms is that the managing broker bears the primary responsibility for training and coaching.

Training of new licensees is labor intensive, especially in light of the constant recruiting efforts necessary to create a constant stream of new agents onboarding. And the work of training takes time away from the rest of the agents at the brokerage, recruiting, oversight, and management.

Mid-Tier agents are the brokerage's bread and butter in terms of cashflow and profitability.

Training for the mid-level agent is typically focused on revenue-generating activities with accountability. Much of this training is more about motivating (or re-motivating) the Mid-Tier agent rather than product knowledge or nuts and bolts of a transaction.

The managing broker has very little incentive to encourage them to get more training and get more productive. When Mid-Tier agents get more productive, they invariably demand lower splits, which means less profitability for the office.

A majority of top producing agents only take required continuing education training to maintain their licenses. Most are so busy serving their clients and building their teams, that brokerage training programs are not all that relevant to them. They are certainly not going to pay for training, whether through fees or splits.

The pressure on traditional brokerages to create these educational opportunities requires that they have classrooms, course materials, trainers (often the managing broker), audio-visual equipment, computers, and in larger companies, entire training departments, all of which puts even more pressure on the profit margin.

The NGB Approach: Specialization

The NGB takes an entirely different approach. The managing broker role is essentially eliminated. Instead, individuals and teams take over major areas of the managing broker's portfolio and *specialize* in them.

A centralized broker team specializes in the legally required supervision and compliance work, which includes agent support. Sam DeBord of Coldwell Banker Danforth describes his setup as basically a customer service call center with brokers.

Recruiting would be handled by a different department that does nothing but recruit new agents. Training would no longer be the managing broker's responsibility, since there is no such position in function even if it exists in name. All of the accounting and financial management would be handled by the finance department. Technology would be handled by IT.

Specialization results in massive gains in productivity of the company as a whole.

Another benefit of specialization is expertise, which leads to even more efficiency.

Finally, specialization goes hand in hand with technology. It is far easier to create software that automates a narrow set of tasks rather than one that helps a generalist.

Operational Scale

Back of house technology plus specialization then leads to real competitive advantages in operational scale. That's a good thing because the one true weakness of the NGB model is that it requires scale to be profitable.

NGB operators said you need at least 100 agents doing an above-average number of transactions to make the model work. Most agreed that once you get to 300 or more agents is when the economics really start to make sense.

The NGB uses all the usual ways to drive scale, albeit with a specialized recruiter who does nothing but recruit new agents to the company. But there is one distinct feature shared by NGBs.

Culture of Freedom

The distinguishing feature is what I'll call the culture of freedom that exists at most of the NGBs.

Khorramian of Big Block more or less speaks for the NGB when he says that he will allow the agent to do whatever he or she wants, as long as the BRE (California Bureau of Real Estate) says it's legal.

This incredibly libertarian attitude is a distinguishing hallmark of the NGB.

As a general rule, all NGBs are very strict on legal and regulatory compliance, and laissez faire on just about everything else.

The Why

We have covered how the NGBs work. But *why* do these companies work today? Why didn't we see them emerge prior to the 2000's? What changed?

Technology Changes

The first and most obvious change is technology.

While technology has not disintermediated the real estate agent, the broker most certainly has been.

Three of the most important changes over the years over the past 20 years explains why the NGB has risen at the expense of traditional brokerages.

Hardware

Xerox DocuTech, circa 1990

In 1999, BizJournals reported that "a quality color copier can be purchased for as low as $13,000." 1999 was *after* the Internet hit the public consciousness in a big way.

Brokerages provided enormous value to their agents by providing them with productivity technology, most of which were too expensive for the individual agent to purchase on her own.

Plus, most of the machines were quite large. The printers, copiers, computers – all were rather large machines requiring some actual physical space.

All of that led to major advantages in having a physical office, with physical desks with physical desktop computers on them, a physical laser printer around the corner, and a giant color copier for the office.

Every single one of these technologies has gotten cheaper, faster, better, and importantly, *smaller*.

Impact of Mobile

Real estate agents have always been early adopters of communication technology. Much of a real estate agent's work consists of talking to people: prospects, clients, other agents, loan officers, inspectors, contractors.

With the advent of small laptops, Wi-Fi everywhere, and smartphones, the real estate agent no longer needed a physical location at all.

Information Technology and the Internet

Smartphones and Wi-Fi and light and powerful laptops would not have come into existence were it not for the simultaneous and parallel improvement of information technology.

That the internet changed everything is a given. The most important changes for the real estate agent are:

(a) The MLS went online; and

(b) Property information became available to the public over the web.

The former meant that the agent was no longer tied to a specific terminal at the brokerage office. The latter meant that their buyer clients were suddenly able to search for properties without needing to stop by the office to look through the MLS book or sit with the agent at the MLS terminal.

Once again, the agent's need for a physical location was reduced.

The upshot is that it is now possible for a real estate agent to conduct the entire transaction electronically, using electronic forms, digital signatures, and the wide array of communication tools at her disposal.

Leads and the Rise of Portals

The industry talking points and conventional wisdom is that the portals have interposed themselves between the brokerage and the consumer and have hijacked the flow of leads from buyers to listing brokers and listing agents.

The reality is far more mundane: the portals have taken the place of newspapers for real estate advertising. But there is a critical difference between the two for brokerages.

In the newspaper advertising era, the brokerage spent its own money on buying expensive newspaper advertising, then charged the agents for their share. By using their size and scale, the brokerages were able to secure lower rates for individual agents than if they had gone to the newspapers directly.

That was real value.

On the whole, the buyer lead generation funnel was controlled by and paid for by the brokerage who then charged the agents for their individual share.

If the brokerages had embraced the online portals early on and done similar group-buy bulk deals with them, it is entirely possible that the way to buy leads from Zillow or Trulia today might be to do it through the brokerage. They did not, so the portals went direct to the agent.

The individual agent found that it was less expensive, more efficient, and more liberating to buy leads direct from the portals than through her broker.

Brokerage of One

The net effect of all of these technologies and the changes from the impact of all these technologies is that today's real estate agent is, in many respects, a Brokerage of One, who can be fully self-sufficient.

She needs a broker only because state licensing laws and regulations require her to have a broker.

This radical independence and self-reliance of the agent lead to the NGB.

Traditional Brokerages Tried to Defend, Rather Than Adapt

So why didn't the traditional brokerages see the trends and adjust?

Change is Gradual, Until It's Not

First of all, it is easy to see the impact of technology on business models and viability after the fact with 20/20 hindsight.

In real time, as things were changing, the potential impact of decisions is much, much harder to see.

There are also black swan events, such as the collapse of the housing market that caught just about everybody by surprise. The collapse devastated the industry. Many brokerages were too busy trying to stay afloat to pay attention to investing in new technologies or changing business models to cope with the changing times.

Let's cut the traditional brokerages a break.

Change is Hard

Even those brokers who saw the trouble ahead would have found it difficult to adapt. It required real sacrifice in the here and now for a potential gain in the future, which was and is never certain.

Adapting in advance of manifested problems means sacrificing revenues, profitability, and market share for the possibility of a stronger position in the future.

We cannot underestimate the difficulty of changing an existing business model, especially if those changes require mass layoffs of managing brokers who are responsible for recruiting all of the agents in an office.

Again, let's cut the brokerages some slack.

Their Focus Was Elsewhere

Furthermore, traditional brokerages didn't see the NGB coming because the NGB was riding in the wake of the monster that was Keller Williams.

Traditional brokers were so busy focusing on KW that they couldn't be bothered with small startup companies who seemed like a gimmick play that couldn't possibly survive financially.

Agent Expectations

Finally, the expectations of the agents have really changed in the past ten years or so, leading to the explosive growth of the NGB.

Just as the internet brought information about housing to consumers, it has brought information about brokerage options to agents.

Where the NGBs are ahead of the curve is in understanding what it is that agents still demand from their brokerage: community, support and engagement from the managing broker, legal and regulatory compliance, and basic training and technology.

The NGB works today because agent expectations have fundamentally changed. What they want and need from a brokerage, from a broker, are no longer what they once wanted and needed. Technology is the reason for many of those changes, but there may also be a social and cultural shift going on.

Agents need their brokers, but they don't *want* their brokers. They all want to be entrepreneurs until things go sideways, then they want you to clean up the mess.

The NGB is a Real Estate Coworking Space

Our thesis is that the NGB is best thought of not as a real estate brokerage but as a **niche coworking space company**.

The NGB is, in effect, the adoption of the coworking space movement and philosophy into the real estate industry. The NGB is a broker, legally speaking, who does do all of the things a broker is required to do.

Outside of that limited role, however, the NGB is actually operating a coworking space for real estate agents.

NGB as a Cultural Movement

One way to think of the NGB, then, is to think of it as a *cultural* movement, rather than a new business model.

Big Block Realty office in Carlsbad, CA

Traditional brokerages emulate lawyers and bankers. They want to convey solidity, conservatism, stability, expertise, maturity and a respected (and respectable) brand image.

In contrast, NGBs emulate startups and WeWork. They want to convey an image of being hip, cool, smart, fun, and offer a non-coercive environment.

Traditional brokerages always have stars: the top producers who do the most volume. The NGB has very little preferential treatment of top producers since everything is transaction fee based.

The culture that this difference in economic impact between a top producer and an average producer creates is different. In a traditional brokerage, the top producer is like a superstar athlete. In an NGB, the top producer is merely one among equals, exactly the same as a successful member of a coworking space might be.

How NGB Could Evolve

Given this insight, we might think one step ahead and consider how the NGB might evolve into the future. We look not at real estate brokerage, but at coworking spaces for hints as to how trends in that industry might translate into real estate.

Cross-Pollination

An obvious evolutionary path is to separate the legally-mandated brokerage functions (compliance, contract review, etc.) into merely a tenant of a larger Real Estate Coworking Space concept that invites in related businesses at first, and everyone else second.

The goal would be to foster that interaction between customers and the connectivity between disparate sectors serving real estate to help create opportunities for innovation and partnership.

Less Broker, More Social

Although we have seen that the contemporary agent is a Broker of One, she still has personal needs. Personal amenities, childcare, concierge services, social events, private gyms for working out, etc. are all valuable services that agents would pay for.

The social aspect of coworking cannot be underestimated, so we should see the NGB become more and more about social connections and community, and less and less about legal requirements and compliance.

More Physical, Less Virtual

The interesting upshot is that the NGB could end up becoming far more *physical* in the next stage of evolution.

There is no longer a need for a physical office for a Brokerage of One real estate agent. But there is a need for physical space for socializing, networking, and connecting.

The future then, is physical not virtual for the NGB.

Summary of Recommendations for Brokerage

Please turn to the Recommendations section at the end for a much more detailed discussion of each of these.

- **If You Can't Beat 'Em…**

  The first answer has to be to copy as much as what works for the NGB.

  - **Back of House, Not Front of House, Technology**

    The first place is to stop obsessing about the consumer or agent-facing front of house technology. Instead, focus more on back of house technology that would make your W2 employee paid staff more productive.

  - **Get Rid of Front of House Technology**

    Wherever possible, emulate the NGB in not paying for front of house technology. Whatever system you the broker provide should be the baseline. Don't worry about agent adoption.

- ### Steadily Cut Costs

  One of the things that NGB operators all brought up was that traditional brokerages waste a lot of money on unnecessary expenses.

  Cut every expense that does not have a clear and quantifiable return on investment.

- ## Centralize and Specialize

The next step is to centralize and specialize as much as possible. This is the most difficult step because it does require overhauling your organization.

Take intermediate steps if possible. Free up some of the managing broker's responsibilities.

Corporate functions such as accounting, marketing, HR, and technology can all be centralized and removed from the responsibilities of local office staff.

- ## Skip Ahead: Brokerage

As a general matter, we are not fans of playing catchup with the competition. We think it's better to skip ahead and try to become what they will ultimately become or become their nemesis.

One path is to attempt to become The Platform – or an important Market Maker on the Platform. If you have the resources and access to capital, this is an excellent path to explore.

We believe that the ultimate future of brokerage is a W2-based model like Redfin, but on a smaller scale as a local niche boutique. That would be another path.

- ## Skip Ahead: Real Estate Coworking Space

The alternative might be to skip ahead and become an actual real estate coworking space.

The NGB has brought concepts from the coworking space world into real estate, fusing it with brokerage. A viable strategy, then, is to skip ahead to the future of the NGB and become a real estate coworking space company instead.

- ## Make Smart Acquisitions

For larger companies and for national franchises, I recommend making some smart acquisitions instead of trying to build this from within.

Rather than acquiring front-of-house technology companies, acquire successful NGBs with dynamic leaders who can teach you what you need to know.

Orient.

MAIN SECTION

In August, Inman News reported that Keller Williams, the largest brand by agent count in the world, and the originator of some of the greatest innovations in the history of residential real estate was launching a virtual brokerage:

> Keller Williams has announced plans to expand into the virtual brokerage space through its fleet of nearly 200 expansion businesses, the real estate franchise's chief executive confirmed with Inman on Monday. The move comes at a time when virtual brokerages like eXp Realty and Real are widening their influence in the industry.
>
> During last week's Keller Williams Mega Camp, a company retreat for select Keller Williams leaders, Keller Williams CEO John Davis said the new business model will be available to 166 expansion businesses, representing 509 locations and 3,433 real estate agents. Expansion businesses closed 42,218 transactions in 2017, representing $12 billion in sales volume.
>
> "What we're seeing with our technology, what we're seeing with our innovation, we're preparing for the next 15-20 years down the road, and we're really excited that technology is allowing us to do this," Davis told Inman, when reached by phone on Monday. "We couldn't be more thrilled with everything that's going on."

I thought this news was important for one reason: it is the first time I have ever seen Keller Williams react to someone else. In this case, that someone else is the upstart eXp Realty, a "virtual brokerage" based in Bellingham, WA who has taken a page from the Keller Williams playbook and adapted it to the realities of 21st century real estate.

For most of its 35-year history, Keller Williams ("KWRI" or "KW" hereafter) had the initiative. KWRI acted, and the real estate industry reacted. Brokerages and agents often complained about KWRI, calling it a "multi-level marketing scheme" and even a cult, but most brokerages have had to either follow KWRI in key strategic areas (e.g., agent teams, caps on commissions) or at least react to KWRI in some fashion. For example, Realogy throughout its life as a public company, would often mention KW by name as a major competitive threat that was compressing Realogy's profit margins.

It's an important factor in the success of the NGB, but the real reason is that they have taken the original Re/Max agentcentric model to the next level. They practice a contemporary, technology-powered form of agentcentric brokerage that is a perfect fit for our time. Low cost is merely the result of that evolution.

For KWRI to react to someone else is, I thought, surprising. Not only that, but the reaction itself points to a deeper issue in real estate: the death of the traditional split-based models.

There are numerous reasons why traditional brokerage is dying, but at the top of the list (at least in the short and medium terms) is the emergence of the Next Generation Brokerage ("NGB" hereafter). The industry often refers to them as "100% shops" with a faint sneer, but low-cost is just one reason why the NGB is successful. Truth is that the NGB practices a contemporary, technology-powered form of agentcentric brokerage that is a perfect fit for our time. Low cost is merely the result of that evolution.

This report is broken up into three general sections. We first examine how the NGB works. We then turn to the question of *why* the NGB works today—why what they are doing is the contemporary, next generation of agentcentric model. We then present our organizing thesis about the NGB and speculate on the model's future evolution.

The How

Each individual brokerage or brand is different, of course, but as a general matter, all NGBs share certain traits and practices in common. They cannot function without them.

The Evolution of Agentcentric Models

Dave Liniger invented agentcentric brokerage in the late 70s when he founded Re/Max. He wasn't the originator of the model; that honor goes to Realty Executives out of Phoenix. But Liniger was the man who took the concept national and transformed the industry.

The incumbents at the time denigrated Re/Max as a low-cost bargain basement bottom feeder. Steve Murray of Real Trends, who has forgotten more about the history of real estate than most people ever knew, says that at one time, Dave Liniger might have been the most hated man in real estate for his low-cost, agentcentric model.

But his idea and his business model caught on. As the Re/Max official history puts it, Liniger's "controversial idea [was] to build a real estate powerhouse where experienced, productive agents would keep more of their commissions and enjoy the freedom to run their business as they saw fit." It was the birth of the agentcentric model.

The rest of the industry had to follow his lead, or face extinction as agents fled brokercentric 50/50 companies in droves. They too converted to an agentcentric model.

In the 90's and 2000's, Gary Keller took the Re/Max model to the next level by expanding Keller Williams outside of Texas. He refined the Re/Max model further. The Keller Williams Business Model, according to the official website, is:

- The best possible commission structure
- Treat agents like business partners
- Profit share with the agents that help grow the company
- Give full access to financial information to all associates
- Formalize input on how the office should be run via the ALC (Agent Leadership Council)

- Have supportive management that consults, trains and promotes teamwork
- Have the highest level of training in the industry

The innovation that KW is known for is the cap on commissions:

> When you are comparing real estate companies and commission splits, you are more than likely going to come across the 50-50 split. This is the most common type of commission arrangement that traditional real estate firms use. This split can continue for as long as you are selling, or it can operate with a sliding scale. Based on your production, it can move to 60-40, 70-30, 80-20 and so on. The most important thing to notice here is you will always be paying your broker a fee. There is no cap or end in sight.
>
> With the Keller Williams commission split, you know exactly how much you pay your broker before you sell anything, and the best part is if you don't reach your cap, you're not required to pay the difference. Bottom line, if you don't succeed, Keller Williams doesn't succeed. By offering a cap on commissions, KW gives agents the best opportunity to take home more money than any other real estate business model.

The other major innovation that propelled KW to its commanding heights is its early embrace of and promotion of the agent team.

In fact, Gary Keller wrote the book on agent teams: *The Millionaire Real Estate Agent*, first published in 2004.

Finally, KWRI focused intensely on training and coaching as a value proposition. Gary Keller is supposed to have said that Keller Williams is a training and consulting company that just happens to sell real estate.

The NGB has taken Keller Williams and its culture of agentcentric brokerage to the next level.

Specifically, the NGB founders and operators—many of whom come out of the agent ranks—recognized that the value proposition of brokerages, even Keller Williams, had changed as technology continued its inexorable march. They saw that by leveraging technology in a new way to drive efficiency throughout the brokerage operation, they could actually operate a profitable business at a fraction of the cost of even the capped KWRI model.

In fact, what the NGBs have hit upon is the logical endpoint of the agentcentric model where the brokerage more or less disappears as an organic unified entity and becomes something more like a loose confederation of independent businesses.

Turns out, the ultimate in agentcentric is the individual agent operating her business, whether solo or in a team, as she sees fit.

Let us go through the key elements.

Because the NGB does not take a piece of the commission, one interesting result is that the NGB does not care about the price of the homes bought and sold by its agents.

Fees, Not Splits

Fundamentally, the NGB generates revenues from fees rather than from commission splits. This is perhaps *the* distinguishing feature between an NGB and a traditional brokerage.

The two most common fees are transaction fees and some sort of a monthly/annual fee that might best be described as a "membership fee". The transaction fee covers the expenses of the NGB in handling the required brokerage services of each transaction (such as contract review and accounting), while the "membership fee" covers the expenses of housing and servicing the agent outside of a transaction. Such expenses might include technology provided by the NGB, networking events, marketing materials, administrative help and training.

Because the NGB does not take a piece of the commission, one interesting result is that the NGB does not care about the price of the homes bought and sold by its agents. Whether the agent sells a $10 million mansion or a $200,000 starter home, the NGB makes the same amount of money from that transaction. In industry terms, the NGB does not care about Sales Volume; it only cares about Transaction Sides.

That small but critical difference has interesting consequences for culture, which we will address further below when we look at Why these NGBs work.

Note that traditional brokerages also charge a number of fees, including transaction fees.

However, we regard these fees as more of a *defensive* move the brokerage was forced to take because of pressure on commission splits, rather than as a core feature of the business model. Furthermore, it's one thing to charge a tech fee and a document review fee when the broker does not take a split; it's another thing altogether when the broker takes 20-30% of the commission amount and still charges a fee. The latter leaves the agent wondering what the broker has done for his share of the commission split.

It's Not the Money (But It's the Money)

One common refrain I heard from all of the NGB operators is that they don't actually compete on price. It's not the money, they say, but *value*. In fact, more than one NGB executive did not like the term "low-cost" as a way to describe them.

"You get what you pay for" is no longer valid in the brokerage business. Sam DeBord of CB Danforth called that a "sucker's cliché" saying that in real estate, it's actually, "You get what you can negotiate."

He noted that CB Danforth was not the cheapest brokerage in his market as they charge the 6% royalty fee that the franchise requires. He also said there were competitors who charged less in monthly fees, transaction fees, and other fees. But he thought that CB Danforth was the least expensive way to affiliate with a top tier brand, and that they delivered far more value at slightly higher price than rock-bottom price competitors did.

Similarly, Sam Khorramian of Big Block Realty said, "Our goal was to provide a Ritz-Carlton experience on a Holiday Inn budget." He said their philosophy is that if the agent joins Big Block Realty just for the money, then they'll leave just for the money. And while he does offer some of the lowest costs in the San Diego area, he says competitors are popping up with even lower costs.

JP Piccinini of JPAR claimed that they provide more than what an agent can get at KW, Ebby Halliday (a large Dallas-area broker, recently acquired by HomeServices of America), or Realogy companies. He called most of the 100% commission brokerages "ghost broker" shops because the broker was nowhere to be found when the agent needed him, whereas broker support was the first thing he wrote in his business plan for JPAR.

Wendy Forsythe of HomeSmart agrees, pointing out that because Phoenix has been ground-zero for the 100% commission model, HomeSmart has tons of lower-priced competitors. The conversation for HomeSmart is around value, not price, and she strongly felt that agents are price sensitive, but only up to a point. "Keep everything you make, but we don't do anything" was not a viable strategy in her view and in HomeSmart's experience.

The refrain is, "We're full-service, but at low cost."

And yet… the 100% commission is at the heart of the NGB's success in more than one way. Obviously, the cost advantage is important. But there are other advantages as well as we will explore throughout this report.

For the agent, it's never about the money, until it's about the money.

Every brokerage in America talks about value, rather than price, and everybody goes along with the pretty lie. It's like the old joke about the Soviet Union: "They pretend to pay us, and we pretend to work." Brokers pretend that they're offering something truly special that the agent can't get anywhere else, and the agents pretend that they're happy to pay the split because of all of the technology and tools and training that the broker offers… until they get to higher production or get a better offer from someone else.

Agent birthdays were the worst in my old company since that was the anniversary date for her split. She would want a better split, and I would have to talk about how her production wasn't deserving of a better split. Or if she had been producing, then I'd have to go along with it knowing that my profitability from her was shot. Making an agent feel bad about herself is never a positive for my relationship with her but losing money on an agent isn't great either.

It was also never a positive meeting when an agent would come into my office with a bottle of wine, wanting to talk. Someone had wooed her away with a better commission plan, and there was very little I could do to keep her. It's not like they ever come to the broker when they are being recruited; they only come and see the broker *after* they've signed a new contract.

So no matter how much they loved me and still wanted me to come over and have dinner or show up at their kids' birthday parties, the money mattered. And it mattered more than my personal attention, training, tools, and other bells and whistles. It always came down to money.

Same, Or Higher, Margins

Despite not taking a cut of the commissions, NGBs have similar margins to traditional brokerages. In fact, in some cases, the operating margins are *significantly* better for the NGB than for the traditional brokerage.

The industry average for profitability is, according to our research confirmed by Real Trends, is 3-4% net profit margin on 15% Company Dollar.[1] In at least a few cases, the NGB operators stated that their net profit margin is "way, way higher" than 3-4%.[2] One company that was willing to disclose its margins is JP & Associates REALTORS, a regional NGB in Texas, led by JP Piccinini. They are expecting EBITDA margins of **34%** for 2018 and their margins in previous years were not too far off from that number.

Steve Murray of Real Trends agreed that the NGB was far more profitable than outsiders expected. His company, the premier valuation consulting firm in real estate, had done valuations for a number of 100% NGB companies in the past two years. He said that once the NGB hits scale – between 300 and 400 agents – their net

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[1] Company Dollar is usually all of the Gross Commission Income (GCI) generated, less the agent's split and any other cost of revenue, such as referrals payments to third party brokers and agents, or franchise royalties. It is the industry's rough equivalent to Gross Profit.

[2] It should come as no surprise that none of the companies interviewed was willing to publicize their confidential financial information.

profit margin is closer to **10-12%** rather than the 3-4% of traditional brokerages.

The implication is that the NGB is generating less in revenues, but far more in profits. That means efficiency and productivity to keep operating expenses extremely low.

So how do they achieve that level of efficiency?

Low Overhead

The first requirement to be an NGB is to reduce overhead expenses to the bare minimum. Operational efficiency, discipline, and as one CEO of an NGB said, “lack of ego” are critical for success.

The two biggest line items in any brokerage operation’s income statement is Occupancy and Payroll. NGBs reduce both to the bare minimum.

Occupancy

According to Mehigan, a corporate real estate consultancy, the typical North American office will average 151 square feet per employee, which is down from 176 sq. ft. in 2012 and 225 sq. ft. in 2010. Thanks in part to the “open space plan” that startup and tech companies have embraced, some companies operate on space as low as 100 sq. ft. of “usable” space per person.

According to Steve Murray, that figure is in line with what traditional brokerages have: between 120-140 sq. ft. per agent.

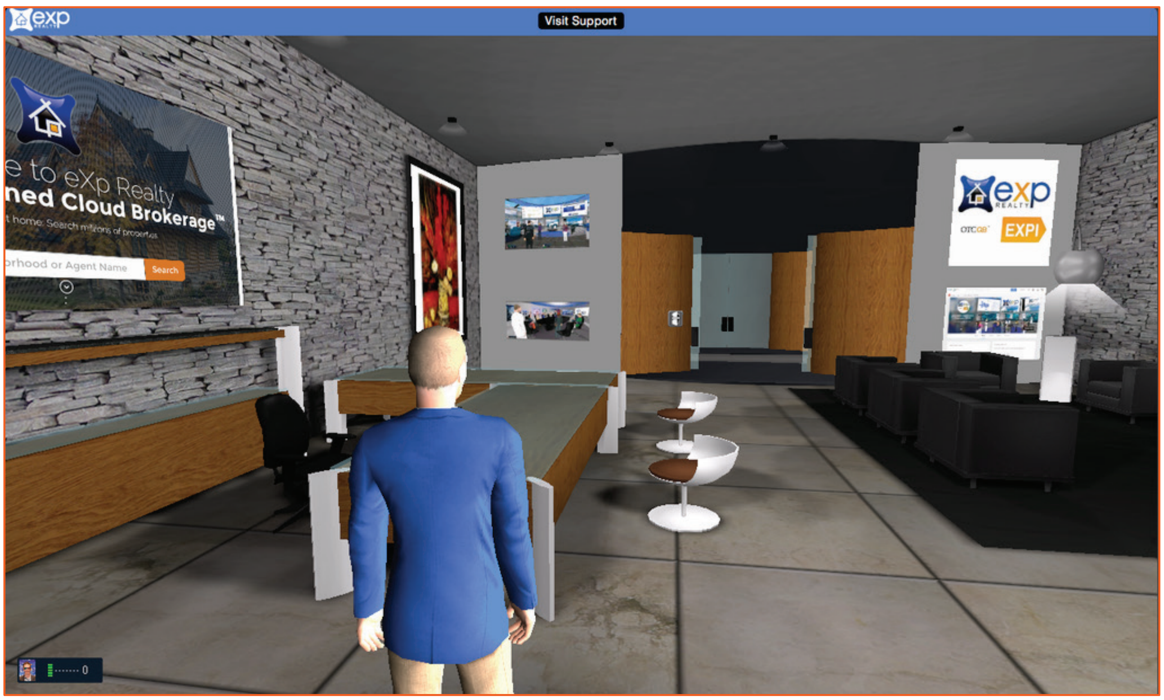
In comparison, the NGB operators *routinely* discuss having 50 sq. ft. *or less* per person. They run comparatively large brokerages out of small physical spaces. They’re designed to do so operationally and financially.

HomeSmart and its franchisees, for example, do have physical offices but the HomeSmart model calls for renting out private desks and offices to agents, with the rental income covering the occupancy costs in full.

The poster child for reducing occupancy costs is eXp Realty, which bills itself as a "virtual brokerage".[3] Instead of physical offices, eXp uses a 3-D online virtual world where its "Cloud Campus" is located. As eXp explains:

> [O]utside of a small accounting office in Bellingham Washington and various offices around the US and Canada which are in place primarily for compliance reasons (certain states don't understand the concept of Cloud-based yet), our real office is on the Cloud.

What if a situation arises when an agent needs an office? Meet a client, or sign paperwork perhaps?



Then she can take advantage of eXp's partnership with Regus:

> eXp Realty agents have free access to Business Lounges in more than 1200 locations across the globe — including most US states, 95 countries and such exotic vacation spots as Cape Town, Dubai and Monte Carlo.

[3] Please note that while I use eXp Realty as a radical example of cutting the cost of occupancy, I do not consider them an NGB. We will explore this in detail below.

> Regus Locations include fully-equipped offices and professional administrative support from center teams as well as access to Wi-Fi. meeting rooms, day offices and video communications. The Regus Business Lounges are free to all eXp Agents with a Regus Card or copy of their Temporary ID #.

Without a physical office, except for those required by law which are not real estate offices as we might understand them, eXp reported that its agent count was 11,856 at the end of Q2/2018.

Time will tell whether eXp's online virtual office is a gimmick or will in fact become a new way for actual productive work. But on that question, it does bear pointing out that a number of companies from Oculus to Samsung to Google are focusing *heavily* on Virtual Reality.

eXp just might be on to something.

Payroll

The other line item that kills brokerage profits is people – specifically, the staff who provide services to the agents. All of these people are W-2 employees with all of the attendant traditional costs.

Compared to traditional brokerages with their layers of management and staff, the NGB operates with a skeleton crew.

The traditional brokerage office is operated rather like a small independent business within a larger corporation. Each has a managing broker who runs the day to day operations, along with office staff to help him.

The typical brokerage office has a receptionist who greets customers and does some light admin work when she's not busy. There's an office manager position who assists the managing broker with administration of the office – staff scheduling, office supplies, etc. The office manager would also assist agents if they needed help. A transaction coordinator is also very typical, with responsibility for entering the transactions into accounting, dealing with title and escrow companies, making sure the paperwork was in order, and managing the CDA (Commission Disbursement Authorization, necessary to make sure the agents got paid) process.

In contrast, an NGB with six offices might have a small team of brokers at a central location handling all of the legal, compliance, and agent support for all six offices. An in-house accounting department would handle all financial work, including CDAs for all agents across all offices.

In this and in other ways, the NGB runs a very lean operation from a staffing standpoint compared to traditional brokerages. One CEO of an NGB told me that he runs a brokerage with over 1,000 agents with a staff of 12.

At my old company, Coldwell Banker Bain, our formula was one staff person other than the managing broker for every 25 agents. With 70 agents, I had three people on staff:[4] an office manager/administrative assistant, a receptionist, and a transaction coordinator. Since none of the staff was licensed, I had to review and sign off on all transaction related documents and work with the agents on their deals.

In addition, my company had a corporate Accounting Department, Tech Support, Marketing, HR (who did not recruit for offices), as well as Training and Education. However, corporate did not want agents calling them directly and all requests and questions had to come through my office staff or myself. In all, corporate staff probably numbered around 35-40 people including senior executives. At the time, my company was the second largest Coldwell Banker franchise in the country with about 1,200 agents at our peak.

Flexibility

One unique practice of the NGB is that they avoid signing long term leases or long-term contracts, even if that means paying higher rents or higher prices.

Flexibility is of paramount importance to an NGB, because they do not want to be locked in to overhead costs they cannot adjust relatively quickly if the business starts to drop.

I tend to regard this emphasis on flexibility as the result rather than the cause of the NGB's high-volume, low-margin business. The

[4] Prior to my arrival, the same office with fewer agents employed six people on staff.

NGB's relentless focus on efficiency allows them to make a profit on very thin margins while giving 100% of the commission to the agent. But that math changes very quickly if the market turns.

The pioneers of the NGB model lived through the Bubble years of 2007-2013. HomeSmart was founded in 1999, Realty One Group in 2005, and the founders of other companies were working in real estate in some capacity when the housing market collapsed.

This level of efficiency is impossible without technology. In fact, changes in technology are what drove and continue to drive the emergence of and growth of NGBs.

One of the things they saw was very successful brokerages going bankrupt almost overnight when Sales Volume plummeted. Their revenues, tied at least in part on home prices, plummeted. Unfortunately, because of their long leases, long contracts with vendors, etc., those brokerages ended up being unable to meet their obligations.[5]

With that lesson in mind, even though their business models are less dependent on home prices, the NGB avoids long commitments it cannot get out of or restructure if business conditions change.

One concrete example came from one NGB CEO who discussed how many traditional brokerages are structured so that the owner of the brokerage also owns the building in which it is housed, so that the lease payments from the brokerage are paid to the owner. In good times, that is a bonus revenue stream. But if the market turns, with the brokerage often being the sole tenant of the building, they run into major problems. As a broker, the owner has to reduce the physical footprint, but as a landlord, the owner cannot afford to do that. Despite the lessons of the Bubble years, many brokers continue this practice today.

The NGB CEO contrasted that situation with his own strategy in which his company only owns multi-tenant buildings in which the other tenants are not tied to the real estate industry and the financial structure is such that their lease payments cover most of the

[5] The source of this insight is NGB operators themselves from my interviews for this Red Dot.

operating costs of the building. Even if the market turns, he is able to reduce the footprint of the brokerage without his property holdings going under.

Leverage Technology

This level of efficiency is impossible without technology. In fact, changes in technology are what drove and continue to drive the emergence of and growth of NGBs.

However, it is important to make a sharp distinction between the *kinds* of technologies that a brokerage needs to have. Wendy Forsythe, COO of HomeSmart, called them "front of house" and "back of house" technologies, borrowing from the restaurant industry.

Front of House

The "front of house" is technology that is visible to agents and to their clients. Marketing, CRM, websites, etc. make up most of this technology.

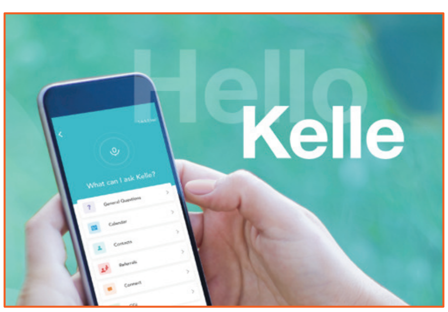
Front of house technology promises to help the agent be more productive and therefore more successful. Whether lead generation (e.g., agent websites/profile pages, automatic syndication to portals, geographic farming systems) or managing prospects (e.g., drip marketing systems, CRM systems) or doing the transaction (e.g., transaction management, e-signatures), the point of these kinds of technologies is to make the *agent* more productive.

Traditional brokerages and franchises sometimes spend enormous amounts of time, energy and money to develop and offer these front of house technologies. The reason is simple: **recruiting**. Technology offerings is one of the pillars of recruiting, and every brokerage everywhere has to at least make a claim of having wonderful technology that helps lead generation, marketing, promotion, and impressing clients.

Realogy, for example, acquired ZipRealty in 2014 for $166 million in large part to get the Zap integrated technology platform. It has since spent four years and enormous resources to roll out the Zap platform across its franchisees and throughout the NRT. Richard Smith has discussed the Zap rollout and its progress in multiple earnings calls.

Re/Max recently acquired booj, a real estate software company based in Denver, for an undisclosed amount stating:

> Ultimately, this will mean better tools for the modern age – covering everything from websites and mobile apps to productivity tools and content-rich systems for generating, cultivating and managing leads. It will mean an upgrade for the RE/MAX technology suite – a complement to other Approved Supplier products you choose to use.



Keller Williams also made news when Gary Keller recently announced that KW was no longer a real estate company, but a technology company. It has rolled out a number of initiatives including Kelle, a virtual digital assistant, and the Keller Cloud, which KW calls "a single platform to run your entire business."

However, these efforts at providing technology solutions have not yet paid off for any traditional brokerage who has really tried it.

Realogy has yet to see any kind of a real return on its $166 million investment into ZipRealty. Perhaps as a result, in the 2017 earnings call, the new CEO of Realogy Ryan Schneider talked about taking an alternative approach to technology:

> And so, I don't think our future is necessarily going to be different than that, e.g., it's not going to be Realogy-only technology solutions get provided.
>
> What I think we are going to have to do is make sure we are incredibly easy for agents to both use our technology not just what we have today, but new things that we develop to help make them successful.
>
> **But also we're going to have to have an open environment, where it's incredibly easy to plug in any of the third-party products that an agent wants to use.** And that's really kind of that standard journey from building kind of closed software to using APIs to build much more open and easily integratable software and things like that. [Emphasis added]

And while Keller Williams is promoting Keller Cloud and Kelle in a big way, in 2010 they launched the Keller Williams eEdge to much fanfare sounding very similar themes:

> Exclusively built for Keller Williams Realty associates, **eEdge** is the real estate industry's first and only complete lead-to-close agent business solution – including lead management, contact management, a marketing library and a paperless transaction system. All your contacts and data feed straight through the system – no double entry, no multiple log-ons.

One wonders if Kelle or Keller Cloud or talk of turning KW into a technology company would have been necessary had eEdge been such a major competitive advantage for KW.

And independent brokerages across the country deploy front of house technology products and tools just about every single day. Their fortunes have not changed appreciably from all that effort.

So, what of the NGB?

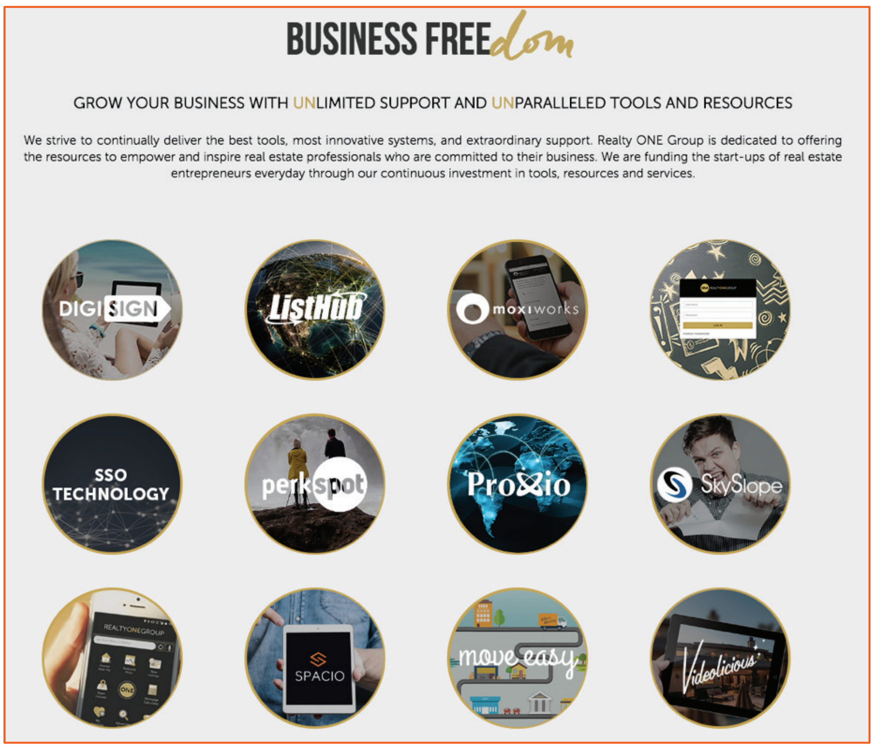
Front of House on the Back Burner

To be sure, the NGB offers these front of house technologies as well. It's just that the focus and the emphasis is not actually on these tools.

For example, HomeSmart offers a whole "Technology Suite of Tools" with these components:

- Broker Management System
- Transaction Management System
- Automated Marketing
- Websites
- Call Capture
- Centralized Services

Realty One Group offers a whole suite of products from a wide variety of vendor partners:



So, it isn't as if the NGB doesn't offer technology platforms. They very much do, and it does form a pillar of their recruiting and retention efforts.

However, dig beneath the surface and what emerges is a fascinating departure from the traditional mindset regarding technology.

For example, Wendy Forsythe said that while HomeSmart does offer a platform for agents, they recognize that agents are going to use what works for them. There is no way to force an agent to use any of the tools offered. This is particularly true for agent teams, which often sets up its own technology systems the way they like, using vendors they like, to support their own processes.

Focusing on the front of house technologies, therefore, is not a top priority for HomeSmart. What HomeSmart provides is more of a "baseline" offering that does a pretty decent job for agents who either do not have such systems in place already or find the value and functionality good enough for being a free offering.

Many of the NGBs take a similar approach to front of house technology: provide something because you have to, just like a hotel has to provide a clean bed, but don't focus on it. That approach also goes hand in hand with the NGB's desire to avoid long contracts and commitments with expenses attached.

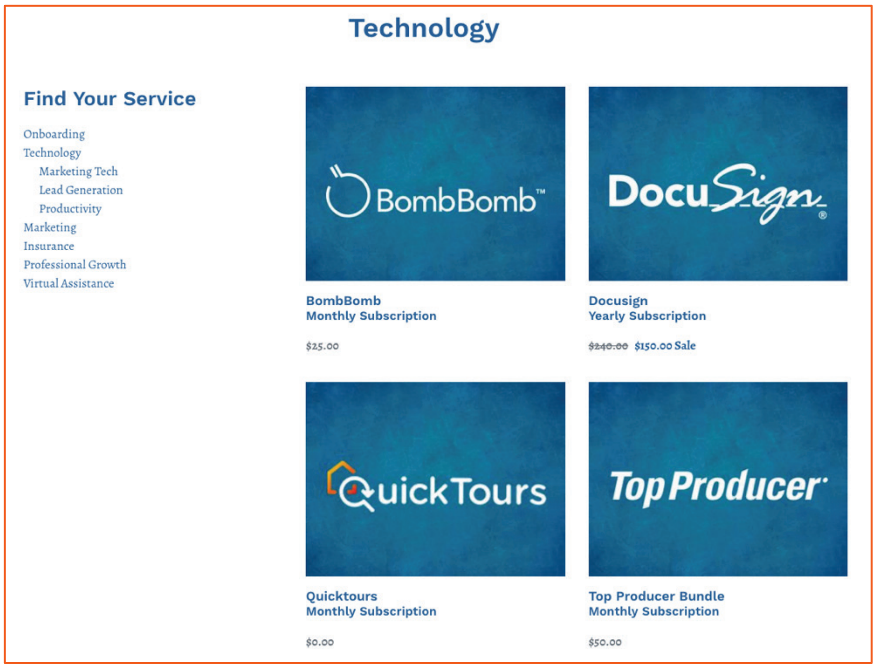
Sam DeBord of Coldwell Banker Danforth says that his company simply takes advantage of the front of house technology offerings from the brand. As a franchisee of Realogy's Coldwell Banker, Danforth's agents get access to CBx, the brand's technology and marketing intranet. They also use the tools provided by the local MLS.

JPAR goes even further. JPAR offers the B.O.S.S.S. (Brokerage One Stop Shop System) platform saying what every other brokerage in America says:

> B.O.S.S.S the brokerage one-stop-shop system provides agents with a host of digital tools to connect with clients, maximize listings and compete ahead of the curve in today's critical market. Founder and CEO, JP Piccinini stated, "We are pleased to provide our agents and teams with the most innovative toolset in the industry allowing them to better serve the consumer and better manage their business. Our trademark is exceeding expectations and B.O.S.S.S. is one step in delivering that experience to our agents and their customers."
>
> Mark Johnson, COO of the firm stated, "We are on a mission to equip our agents and teams with the most innovative tools,

> systems and processes enabling them to become the industry's most productive agents. B.O.S.S.S. is consistent with our desire to serve existing and emerging agent teams and our values of productivity and service."

But in reality, the BOSSS platform is actually a storefront where JPAR agents can go and purchase what they want from technology partners at discounted rates. Vendors will offer a revenue share to JPAR in order to appear on the BOSSS platform. Not only does JPAR not invest in technology, it actually makes money from not investing in technology.



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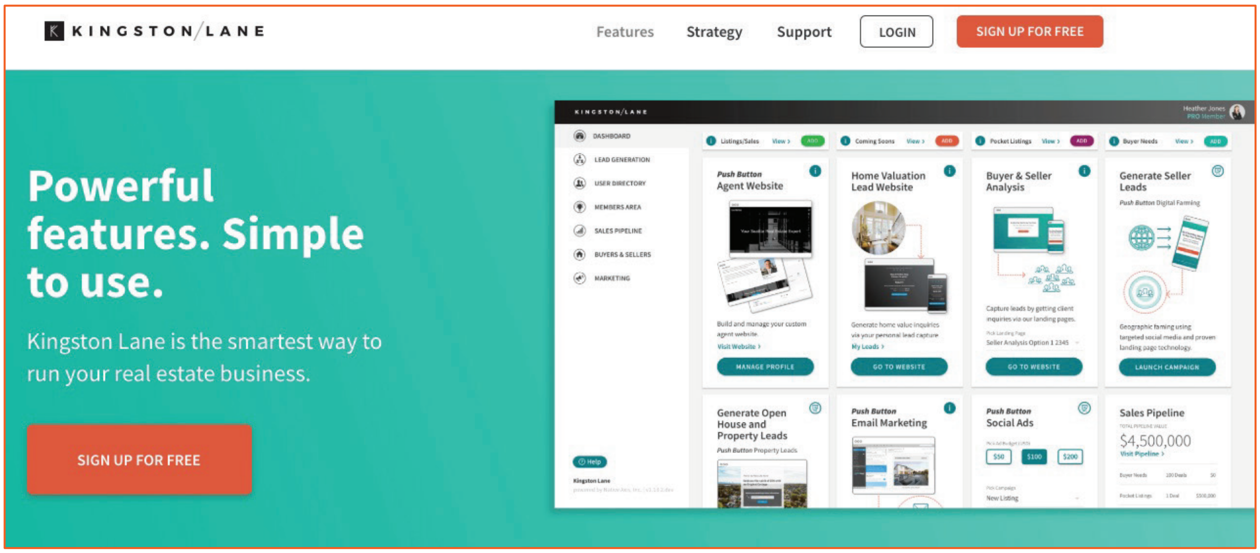
The JPAR approach of partnerships with vendors is remarkably popular, as it avoids any expense for the NGB, but provides a benefit for the agents and for the vendors.

The Vendors Are Better, Cheaper, Faster

The reality is that the technology vendors in the real estate space are just better, cheaper and faster than the in-house solutions at most brokerages not named Redfin.

Take, as an example, the company Kingston Lane which produces "push-button marketing" software as a service for real estate brokers, teams and agents.

They operate on a freemium model, with a base product that is free for life. They then upsell their users to a $99/year Pro plan.



Included in the free plan are:

- Home Valuation Landing Page
- Agent Branding Website
- Push Button Digital Farming*
- Push Button Property Leads*
- Push Button Email Marketing*
- Intelligent Lead Manager
- Facebook Mastermind Group
- Daily Action Plan Emails
- Zapier Integration

The items with asterisks might have additional costs based on advertising costs. But this feature set – which is, incidentally, on par or better than most lead generation and marketing platforms offered by brokerages – is *free*.[6]

If you are a brokerage with an in-house system, like a Realogy brokerage on Zap, how do you compete?

And that's just one example picked because of the rather extreme freemium value proposition. There are other technology companies that sell a variety of products and services to brokers, teams and agents across the cost spectrum. Almost all of them are better, faster, and cheaper than the brokerage's own in-house solution.

It appears that the NGB operators have looked at examples of traditional companies like Realogy and KW and others investing tens or even hundreds of millions into brokerage-provided technology and decided that there was little reward and much risk to that strategy. They would prefer to let the agents pick and choose what they want to use, have the agents pay for those products themselves, and partner with technology vendors with no real cost to themselves.

To be fair, most traditional brokerages have realized the same thing by 2018 and tend to try to work out partnership deals with technology vendors instead of enterprise contracts.

What sets the NGB apart is its focus on the back of house technology.

Back of House

The "back of house" is where the nitty gritty of the operations happen: accounting, recordkeeping, task management, etc. Most of this technology is rarely seen by the agent and is not consumer-facing. Back of house technology is aimed at making the brokerage *staff*, rather than the agent, more productive. And it is essential to how the NGB operates.

For example, centralized teams of brokers and document review staff conducting contract review across the entire company is impossible without paperless transactions. It would hardly be cost-effective to

[6] Like most freemium models, Kingston Lane sells a paid Pro version, with more features. But even the Pro version is only $99 per year. A brokerage wanting to justify a higher split based on technology has a tough row to hoe.

mail or messenger contracts back and forth between the agent in the field and a centralized brokerage operations team in time to get deals done.

Interdepartmental communications, document storage and sharing, centralized calendars, common financial accounting and reporting platforms – these are the mundane tools that allow the NGB to drive efficiency and productivity at the corporate level.

And then there's the 21st century stuff that some NGBs are putting into the field. For example, HomeSmart offices do not have a receptionist. Instead, they use what HomeSmart calls SmartReception, a centralized virtual reception service in which the receptionist sits in a remote central location (i.e., corporate headquarters). When a visitor comes into the office, he rings a bell, which alerts headquarters staff. A TV comes on with the remote receptionist, which provides a level of the human touch, who can speak with the visitor then either contacts the agent in the office to come to the front door or opens the door for the visitor remotely.

Most of this technology is rarely seen by the agent and is not consumer-facing. Back of house technology is aimed at making the brokerage staff, rather than the agent, more productive. And it is essential to how the NGB operates.

Since the back of house technology and the processes that go with it are the secret sauce to the success of the NGB, none of the companies I spoke with wanted their particular details publicized. We do know that JPAR operates on Lone Wolf with custom reports created for them for accounting and uses Skyslope for transaction management and compliance. I have also been told that HomeSmart operates on a platform built entirely in-house.

But whether the NGB uses vendor software or develops its own is not important. What is important is that this less-than-sexy back office technology is where the successful NGB operators focus. This is where they invest, because that investment yields efficiency and productivity from the paid employee staff.

In contrast, in traditional brokerages, the back of house technology is an afterthought. They focus far more on cost to the brokerage rather than on ease of use or staff efficiency and productivity.

For example, at CB Bain, we used Profit Power for our commission accounting and transaction management. To enter a transaction into the system was a *75-step* process. Sometimes, if you made a mistake, you could not go back and fix it; you had to delete the transaction and start over. To make matters worse, even as the managing broker, I could not delete the transaction myself; I had to call the corporate Accounting Department and have them delete it. Once you got proficient in using Profit Power, you could expect to spend 15-25 minutes per transaction just entering it into the system.

Efficient and productive, this was not.

Specialization

Technology alone, however, does not create the level of productivity and efficiency to drive profits on such thin margins. Specialization is the other major distinguishing operational feature of an NGB.

The Traditional Managing Broker

Most traditional brokerages have a managing broker for each office, with day to day responsibility for the overall operations of that office. That also means, however, that the managing broker has to get involved with every single aspect of operations.

So, on the one hand, the managing broker needs to be the ultimate generalist who can go from reading a balance sheet to advising an agent on a contract issue to trying to recruit new agents to the office. Brokers are required to be recruiters, trainers, counselors, bartenders, coaches, hostage negotiators, deal doctors, and managers.

On the other hand, the performance metrics of managing brokers (and therefore their compensation packages) are often tied directly to recruiting and retention, and oftentimes to referrals to affiliated businesses if the brokerage has them. As a result, managing brokers come to understand that the most important job they have is to grow the office by recruiting new agents.

But on the third hand, the position of managing broker is often one *required* by state licensing authorities. For example, here are a couple of relevant sections from the Administrative Rules of the Vermont Real Estate Commission:

4.1 Offices and Branch Offices.

(a) A principal broker shall be in charge of a brokerage firm. The principal broker must maintain his or her place of business at the brokerage firm's main office. The principal broker must notify the Commission of the brokerage firm's main office location.

(b) A brokerage firm which desires more than one office shall register a branch office. A branch office shall use the same name as the main office and shall designate a broker in charge. The broker in charge of a branch office must maintain his or her place of business at the branch office.

(c) The firm's licensees must have a primary place of business at one of the brokerage firm's locations but may work out of any of the brokerage firm's offices.

(d) A principal broker or broker in charge may not serve as principal broker or broker in charge for more than one office or brokerage firm at any one time, except that a broker who also holds a temporary license under 26 V.S.A. §2299 may be associated with a second brokerage firm.

4.2 Broker Supervision.

(a) A principal broker may be vicariously responsible for the professional conduct of licensees and employees of the brokerage firm, including all branches; a broker in charge may be vicariously responsible for the professional conduct of all licensees and employees of the branch office.

(b) Licensees must work under the supervision and training of the principal broker or broker in charge.

The Rules also spell out various duties and responsibilities of the principal broker and the broker in charge as well. While each of the 50 states has slight variations, Vermont's rules are not substantially different from the others in terms of requiring a managing broker, and that the managing broker supervise the work of the agents affiliated with his company.

Brokers are required to be recruiters, trainers (even if there is little to no differentiation), counselors, bartenders, coaches, hostage negotiators, deal doctors, and managers.

This is a role, and these are duties, required by law. Recruiting and retention are important for growth, and the managing broker has to run the day to day operations, but he must fulfill the legal and regulatory requirements. Balls get dropped. Things slip through the cracks. It is inevitable.

To make matters worse, agents don't actually care what else the broker has to do that is a priority – you have to drop what you're doing and switch tasks when they ask. Because if you don't, they'll go down the street to the broker who says they will bend over backwards *and* give them a better split.

Agents might need their brokers, but they don't *want* their brokers. They all want to be entrepreneurs until things go sideways. Then they want the managing broker to clean up the mess.

Yet, this is the way that business has been done for decades, and it remains the way that business is done today for the vast majority of brokerages.

A Note on Training

Every brokerage offers training, because it is a pillar of recruiting. Like technology, training is a given as far as the agent is concerned. A broker saying he doesn't spend any time or money training agents is like a hotel saying they don't provide clean sheets.

What brokerages do is to advertise that they have the best training, with a wide variety of courses, taught by the managing broker or by more experienced agents in the office. While some companies have trainers who have not personally sold, most agents see value in learning from someone who has walked in their shoes.

Because agents only see value up to a point. Most agents are not willing to pay for in-house training; they have come to expect it as part of the package that they pay for through their commission splits.

Furthermore, there is a plethora of free training opportunities today: agent mastermind groups, trainers and coaches who use them as marketing opportunities, REALTOR Associations and MLSs, and oftentimes competing brokerages who use it as an opportunity to recruit.

What that means in practical terms is that the managing broker bears the primary responsibility for training and coaching.

New Agents, Mid-Tier, and Top Producers

An additional challenge is that the broker has to take the experience and skill level of the agent into account. At the same time, the value of training declines as an agent becomes more experienced which in turn puts additional commission split pressure on the brokerage.

New Agents

New licensees are in desperate need of training, since state pre-licensing classes don't teach them anything about helping people buy and sell real estate, write or understand a contract, or generate leads without buying them. They will, however, know how many square feet are in an acre, the year of the Sherman Anti-Trust Act, and what the protected classes in the Fair Housing Act are.

Training on the actual business of real estate sales falls squarely in the lap of the managing broker. And if the broker doesn't do a good job, her license is on the line, since state laws and regulations make the broker liable for wrongdoings of the agent. No pressure.

Training of new licensees is labor intensive, especially in light of the constant recruiting efforts necessary to create a constant stream of new agents onboarding. As a managing broker, I spent roughly 50 hours over 8 weeks with each of my new agents. Best case scenario was to train in small groups of new agents who all joined around the same time. Often, the training would have to be one-on-one.

I taught product knowledge, local market trends, contracts, listing and buyer intake presentations, marketing, negotiations, objection handling, client service, and of course, how to generate leads from their sphere or from a geographic farm.

I also had new agents pair up with more seasoned agents to observe listing presentations, buyer tours, and contract negotiations because nothing teaches you better than real life scenarios. It was my job to make sure they were confident and proficient in representing clients before I released them into the wild.

In addition, my company also offered an optional weeklong, 40-hour course called *Fast Start* for new agents at our corporate training facility. Since it was only offered quarterly and the facility was 100 miles from our office, corporate training did not lessen the training burden on me as the managing broker on the ground, which means that the expense of the corporate training department, corporate training courses, and corporate training facility were all additive to the company.

You can see why many companies don't hire newly licensed agents: it takes a lot of work to get them trained to the point where the broker feels comfortable risking her license. And the work of training takes time away from the rest of the agents at the brokerage, from recruiting, oversight, and management.

Mid-Tier Agents

Mid-Tier agents are the brokerage's bread and butter in terms of cashflow and profitability. For my office, that would mean between 6-10 transactions per year and between $2-$4 million in Sales Volume. The key distinction between the Mid-Tier agent and the Top Producer is that they are productive enough to generate income, but not so productive that they demand better splits.

Training for the mid-level agent is typically focused on revenue-generating activities with accountability. While this is much less hands-on, it does require the brokerage to create and teach engaging material that these agents will want to attend. There is no such thing as mandatory training once you are no longer a brand-new agent.

As a result, much of this training focuses on lead generation, lead conversion, soft skills, discipline and time management, and staying motivated. It's less about knowledge and more about motivation. Otherwise, the agents won't show up.

This group of agents are the prime candidates for third-party training and coaching companies, such as Ninja Selling, Brian Buffini, Tom Ferry and others. The brokerage does not pay for these, so the agent pays for the cost of training and coaching out of pocket.

The odd thing about training and coaching for these Mid-Tier agents is that the managing broker has very little incentive to encourage them to get more training. When Mid-Tier agents get more productive, they invariably demand lower splits, which means less profitability for the office.

Top Producers

Most of the top producing agents that I have worked with simply take the required continuing education training to maintain their licenses. Some will take additional certification courses (like CRS, SRES, etc) to build larger national networks and increased perceived value to potential clients.

But most think they are already experts anyway, whether they really are or not, and are busy serving their clients and building their teams that brokerage training programs are not all that relevant to them. They are certainly not going to pay for training, whether through fees or splits.

Live vs. Online Training

Like everything else, technology has changed the way people learn. Access to training is no longer an issue, and it's all at the agent's fingertips on her laptop or mobile device.

Technology helps brokerages provide agents with a variety of teaching styles and venues. Want to watch a livestream while sitting in your pajamas? We've got you covered. Need to be in a live classroom environment so your mind doesn't wander during class? Cool – we can do that too. Webinar more your speed, so you can pause then continue at your convenience? Here is our library of classes.

Brokerages are forced to provide ALL kinds of training, through all kinds of channels, to all kinds of agents: everything from soft people skills to contracts to marketing to listing presentations. And it all has to be provided at little or no cost to the agent, or she will find seven other brokers who will be happy to oblige.

The pressure on traditional brokerages to create these educational opportunities requires that they have classrooms, course materials, trainers (often the managing broker), audio-visual equipment, computers, and in larger companies, entire training departments, all of which puts even more pressure on the profit margin. God forbid you adjust the splits to account for these expenses as the agent would revolt and leave.

The NGB Approach: Specialization

The NGB takes an entirely different approach. The managing broker role is essentially eliminated. Instead, individuals and teams take over major areas of the managing broker's portfolio and *specialize* in them.

For example, to comply with state laws and regulations, every office will have a designated "broker in charge" or "managing broker" who is duly licensed as a broker. But that individual will often be part of a larger broker team that is centrally located.[7]

This broker team specializes in the legally required supervision and compliance work, which includes agent support – i.e., advising agents on what they can and cannot or should and should not be doing in a transaction. If regulations allow, the broker team might be supplemented with contract review specialists as well as automated contract review technology to make them even more efficient.

JPAR is a great example of how this broker support operations work in real life. They have one designated supervising broker, as required by Texas law. In addition, they have two full-time and two part-time brokers whose primary responsibility is to provide broker support to agents: answer questions, help agents deal with difficult clients, difficult agents on the other side of the transaction, and offer advice.

Those brokers are supported by three full-time employees on the Compliance team who handles all of the document review, transactions details, etc. to make sure that JPAR agents are following government rules and regulations as well as MLS rules and REALTOR Code of Ethics.

Both teams are supported by in-house legal counsel as well.

This team of six-and-a-half (counting two part-time brokers as one and counting legal counsel as a half) supports broker and compliance operations for 1,500 agents across 18 offices.

Sam DeBord of Coldwell Banker Danforth describes his setup as basically a customer service call center with brokers. Questions,

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[7] Note that Vermont requires that a broker in charge "maintain his or her place of business at the branch office" for which he or she is responsible. That may be one reason why we have not heard of major NGBs coming out of Vermont.

inquiries, contract review – whatever was needed would be routed to the first open broker to be handled. And staff would be scaled to balance cost against convenience; agents accept waiting a few minutes to have a phone call answered, but not waiting a day or two to have the call returned.

The NGB's brokerage team doesn't do recruiting; all they do is contract review, compliance and answer questions from agents. The volume of work that the brokerage team can do is far greater per capita than traditional brokerages of comparable size.

This kind of specialization extends beyond just the broker support function for all of the successful NGBs I've interviewed.

Recruiting would be handled by a different department that does nothing but recruit new agents.

Training would no longer be the managing broker's responsibility, since there is no such position in function even if it exists in name.

All of the accounting and financial management would be handled by the finance department. Technology would be handled by IT.

Specialization results in massive gains in productivity of the company as a whole. For example, a traditional managing broker may be at an important recruiting meeting and cannot respond immediately to an agent's urgent question about a contact term. The agent is left feeling stranded. This does not occur at an NGB.

The NGB's brokerage team doesn't do recruiting; all they do is contract review, compliance and answer questions from agents. The volume of work that the brokerage team can do is far greater per capita than traditional brokerages of comparable size.

Another benefit of specialization is expertise, which leads to even more efficiency. A traditional managing broker might be great at recruiting, but suck at training and coaching. A training specialist at an NGB does nothing but training and coaching and is far more efficient at the job.[8]

[8] Better still is what many NGBs do: outsource training and coaching to third-party trainers and coaches, with the agent paying those fees individually. The NGB might

Finally, specialization goes hand in hand with technology. It is very difficult, if not impossible, to create software that helps a generalist do all of his tasks. It is far easier to create software that automates a narrow set of tasks – for example, finding discrepancies in contract language from a standard form.

Operational Scale

Back of house technology plus specialization then leads to real competitive advantages in operational scale. That's a good thing because the one true weakness of the NGB model is that it requires scale to be profitable.

In my interviews with the NGB operators, opinions varied as to the break-even point in terms of agent and transaction count, but all of the people I spoke with said you need at least 100 agents in one office (if you have one at all) doing an above-average number of transactions to make the model work. Most agreed that once you get to 300 or more agents is when the economics really start to make sense.

Specialization and the technology that supports it, as well as the centralization of administrative and oversight functions, allows the NGB to know when to ramp up.

Sam Khorramian of Big Block Realty in San Diego said that he knows that for every 150 additional new agents, he needs to add one Agent Concierge position, and that for every 300 new transactions per month, he'll need to add an Auditor (a member of the compliance team).

A bit of rough math yields interesting numbers. Big Block charges $395 per transaction. 300 transactions per month translates to $118,500 in fee income, or $1.4 million annually. A licensed broker/auditor does not cost anywhere close to that in salary, benefits, bonuses, etc. One can begin to see where the margins can be incredibly healthy for an NGB.

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form a marketing relationship with these third parties for discounted rates and even turn it into a revenue center by taking a kickback from the trainers and coaches.

But to get to those margins, you have to have scale. So how do you drive scale?

The NGB uses all the usual ways, albeit with a specialized recruiter who does nothing but recruit new agents to the company. But there is one distinct feature shared by NGBs.

Culture of Freedom

The distinguishing feature is what I'll call the culture of freedom that exists at most of the NGBs.

Khorramian of Big Block more or less speaks for the NGB when he says that he will allow the agent to do whatever he or she wants, as long as the BRE (California Bureau of Real Estate) says it's legal. His goal is to give his agents and agent teams as much flexibility and freedom as they want, while trying to keep them (and the brokerage) out of regulatory or legal hot water.

Wendy Forsythe of HomeSmart related a story about going to a company event and meeting an agent who had been with the company for five years but had never gone into the office to which he is assigned even once.

There are no sales meetings, no prohibitions beyond those imposed by the government, the MLS, or the Code of Ethics, and no requirements beyond the bare minimum. So, for example, all agents of every NGB is required to use the company's system to input transaction details, but only because the company has to cut them a commission check for the right amount at the right time.

This incredibly libertarian attitude is a distinguishing hallmark of the NGB.

That laissez-faire attitude is especially appealing to agent teams. Though pioneered by KW, agent teams with a lead agent and a group of team member agents have all but taken over the industry. Since they function more or less as a brokerage-within-a-brokerage, traditional brokerages were slow in even allowing their agents to form these teams.

The libertarian culture of the NGB goes a step beyond what KW has pioneered. KW, as a company focused on training and education, tends to have a "KW Way" of doing things which includes how to operate a team. The NGB does not. If an agent wants to run her team in the "KW Way" then that's her prerogative. If she wants to do something differently, that's okay too, as long as it is legal.

There are variations between the NGBs, like in any other segment. JPAR, for example, does not allow its agents to discount their commissions; Big Block Realty, on the other hand, merely prohibits *advertising* discounted commissions on the grounds that such advertising could force other agents under the Big Block Realty brand to discount their commissions.

But as a general rule, all NGBs are very strict on legal and regulatory compliance, and laissez faire on just about everything else.

The Why

We have covered how the NGBs work. But *why* do these companies work today? Why didn't we see them emerge prior to the 2000's? What changed?

Technology Changes

The first and most obvious change is technology. When the Internet came of age, quite a few people both inside and outside the industry thought this meant that technology would disintermediate the real estate agent. But that simply hasn't happened.

This article at Harvard Digital Initiative by one of the cofounders of RentHop is illustrative:

> RentHop, an apartment search marketplace founded in 2009, started with the premise that real estate agents were no longer adding enough value to justify high transaction fees. Three years later, after many business model pivots and skirmishes with the brokerage industry, RentHop finally embraced the real estate professionals. Today, this company and a slew of peer competitors earn a majority of their revenues matching buyers to brokers.

The conclusion, echoed by the likes of Spencer Rascoff, CEO of Zillow, is that the real estate transaction is highly emotional, and people want an expert to help them.

What those conclusions about technology and real estate miss, however, is the impact of technology not on the real estate agent, but *on the real estate broker*.

The agent might not have been disintermediated (yet), but the broker most certainly has been. Most brokerages feel the disintermediation somewhere in the back of their brains (or in the pits of their stomachs), but they don't *know* it. Yet.

Three of the most important changes over the years over the past 20 years explains why the NGB has risen at the expense of traditional brokerages.

Hardware

Xerox DocuTech, circa 1990

In 1999 when HomeSmart was founded, the HP LaserJet 8100DN – the PC Magazine Editor's Choice for Workgroup/Office laser printer – cost $3,300.[9] For that price, you got 1200 dpi (dots per inch) at 32ppm (pages per minute). Today, you can purchase a HP LaserJet P2055dn from Amazon for $678.00 and get 1200dpi at 35ppm.

The same tale can be told of just about every single piece of office productivity technology. Copy machines, scanners, computers, telephones, postage machines, and on and on it goes.

In 1999, BizJournals reported that "a quality color copier can be purchased for as low as $13,000" which was a "big drop from five years ago when a typical machine went for around $50,000 and the finished copy was inferior to that being produced today."

Keep in mind that 1999 was *after* the Internet hit the public consciousness in a big way. Nonetheless, brokerages provided enormous value to their agents by providing them with productivity technology, most of which were too expensive for the individual agent to purchase on her own.

[9] PC Magazine, June 8, 1999. Found on Google Books.

Not only was the technology expensive, most of the machines were quite large. The printers, copiers, computers – all were rather large machines requiring some actual physical space. Laptops were still in their infancy and were heavy, boxy, expensive and slow compared to desktops. Wi-Fi was not a thing, which meant physical ethernet cables. Naturally, most people were still working on desktops in 1999, which implies the need for a desk.

All of that led to major advantages in having a physical office, with physical desks with physical computers on them, a physical laser printer around the corner, and a giant color copier for the office.

Every single one of these technologies has gotten cheaper, faster, better, and importantly, *smaller*. This is critical, because one of the changes that drove the emergence of the NGB is the shift away from computers to mobile devices.

Impact of Mobile

Real estate agents have always been early adopters of communication technology. It's natural given what it is that a real estate agent truly does for a living: communicating with and facilitating communication among different parties to a transaction. Much of a real estate agent's work consists of talking to people: prospects, clients, other agents, loan officers, inspectors, contractors.

Real estate brokerages were among the first local businesses to get a telephone, for example. They were early adopters of fax machines, which allowed documents to be shared quickly over copper wire. They adopted cell phones when cell phones were expensive, large, and featured monthly calling plans measured in tens of minutes.

When the first voice-only mobile phones became truly widespread, real estate agents no longer needed to go to the office to make a phone call. They could and did just make calls from anywhere. But for working on documents, sending email, or searching the MLS (which were either printed books or client-server machines hooked up to a dedicated terminal at the brokerage office), they still needed to go into an office.

With the advent of, and the rapid proliferation and improvement of, smart phones pioneered by Apple, even that began to change.

Simultaneously, laptops became smaller, cheaper, faster, and more capable than ever. Wi-Fi went from a rarity to ubiquitous.

Suddenly, the real estate agent no longer needed a physical location at all.

Information Technology and the Internet

Smartphones and Wi-Fi and light and powerful laptops would not have come into existence were it not for the simultaneous and parallel improvement of information technology.

Word processing, spreadsheets, graphic design software, databases on personal computers, shared calendars – the hardware drove software improvements, and ever more powerful and useful software drove hardware to be faster, cheaper, better.

That the internet changed everything is a given. The most important changes for the real estate agent are:

(c) The MLS went online; and

(d) Property information became available to the public over the web.

The former meant that the agent was no longer tied to a specific terminal at the brokerage office. The latter meant that their buyer clients were suddenly able to search for properties without needing to stop by the office to look through the MLS book or sit with the agent at the MLS terminal.

Once again, the agent's need for a physical location was reduced.

Two specific developments in IT are worth looking at for our purposes: electronic documents and digital signatures.

With electronic documents, much of the paperwork involved in a real estate transaction was not paper, but digital. The files that the agent needed – and the brokerage needed for compliance – no longer needed to be printed and sent hither and yon. They could be stored on a computer (and more recently, in the cloud) and sent via email or web download easily.

The entire centralized compliance piece of the NGB cannot exist without this development. Tiny offices handling thousands upon thousands of transactions cannot exist without electronic files; the filing cabinet needs alone would require space.

Nearly as important is the development of, and the social and legal acceptance of, digital signatures. Prior to digital signatures, paperwork could be worked on digitally, but when someone needed to sign a form, it had to printed out and physically signed. While some jurisdictions and companies still require 'wet signatures', more and more companies in real estate are using digital e-signatures from vendors such as Docusign.

The upshot is that it is now possible for a real estate agent to conduct the entire transaction electronically, using electronic forms, digital signatures, and the wide array of communication tools at her disposal.

Leads and the Rise of Portals

That the rise of third-party websites that aggregate listing information for display to consumers has disrupted the real estate industry is not exactly news. But we want to look at the impact of the portals on brokerage, and not much has been written on that particular topic.

The industry talking points and conventional wisdom is that the portals have interposed themselves between the brokerage and the consumer and have hijacked the flow of leads from buyers to listing brokers and listing agents.

The reality is far more mundane: the portals have taken the place of newspapers for real estate advertising. But there is a critical difference between the two for brokerages.

Print vs. Online Advertising

Trulia and Zillow in their early days pitched their advertising to brokers and agents on the basis that online advertising was exponentially cheaper (and increasingly more effective, as consumers were going online more and more) than local newspaper or print magazine advertising.[10] That pitch was appealing, as local newspapers often charged exorbitant rates for classified advertising.

In 2006, prior to Trulia and Zillow really emerging,[11] Entrepreneur magazine wrote about classified newspaper ads:

> **Typical Cost:** $5 to $100 per line, depending on the publication, geographic areas, time of year, number of ads you buy, and whether you sign a contract or purchase ads on a week-to-week basis.

That was for standard classified advertising. Many brokerages did special supplements, full page ads, and other kinds of non-classified advertising for their agents and properties. Those kinds of advertising cost in the thousands and tens of thousands per month.

Prior to my taking over as the managing broker, my office at CB Bain was spending $20,000 per month for an 8-12 page "Buyer's Guide" special insert in our local newspaper. We also got the bottom half of the front page of the Real Estate section in the Sunday paper. This was advertising in a small local newspaper serving a county of roughly 200,000 people. This was not the New York Times or San Francisco Chronicle we're talking about here.

The Purchasing Power Issue

The misstep, in retrospect, was that brokerages—particularly the large brands like Realogy, HomeServices, Remax, etc.—didn't exactly embrace online advertising. Instead, they initially chose to rebuff the portals. After all, by 2006 most of the larger firms already had their own websites up and running and were investing millions into them.

So instead of doing huge enterprise deals with large brokerages and brands, which was their preference and original strategy, the portals were forced to pivot and sell directly to the individual agent.

What the brokerages did not realize then is how that changed the relationship between them and their agents.

[10] I personally heard these pitches as the Sr. Director for Interactive Marketing for Coldwell Banker Commercial at Cendant.

[11] Trulia and Redfin were founded in 2004, Zillow in 2006.

In the newspaper advertising era, the brokerage spent its own money on buying expensive newspaper advertising, then charged the agents for their share. By using their size and scale, the brokerages were able to secure lower rates for individual agents than if they had gone to the newspapers directly. An agent could spend $500 on a 10-line classified with one photo or spend $250 for her share of the broker's $20,000 multi-page special insert in the Sunday papers.

That was real value.

In other cases, the brokerage or the brand negotiated with newspaper publishers for bulk discounts for their agents even on classified and other advertising.

Combined with consumer's need to visit a broker's office to see what was for sale in the MLS (or call an agent to do that for him), on the whole, the buyer lead generation funnel was controlled by and paid for by the brokerage who then charged the agents for their individual share. Yes, agents took over much of the lead generation, which is what allowed Remax and then KW to succeed, but pre-internet, the brokerage had an important role to play and therefore value to the agent.

If the brokerages had embraced the online portals early on and done similar group-buy bulk deals with them, it is entirely possible that the portals would not have built out massive sales operations designed to make retail sales to one agent at a time. It is possible that the way to buy leads from Zillow or Trulia today might be to do it through the brokerage.

But that isn't what happened. What happened was that the portals built up a salesforce and a business model to go after individual agents, did so successfully, and the individual agent found that it was less expensive, more efficient, and more liberating to buy leads direct from the portals than through her broker.

All of the brokers and agents complaining about the portals forget that there are tens of thousands of individual agents and agent teams who made fortunes from the leads from these companies without the broker being involved in the least bit.

To say that brokerage value proposition was and remains affected is a bit of an understatement.

The NGB simply adapted to the reality of the situation. One CEO said, "We tell our agents that they don't pay us enough for us to do lead generation for them." The NGB will happily teach you how to do lead generation and give you 100% of the commission so you can pay for your own, but it isn't going to put in a ton of effort trying to generate leads for you.

Brokerage of One

The net effect of all of these technologies and the changes from the impact of all these technologies is the realization of the U.S. Army's old advertising campaign: Army of One. Today's real estate agent is, in many respects, a Brokerage of One, who can be fully self-sufficient.

She doesn't need an office, not with modern communication technology, MLS access via mobile app, the wide array of communication tools from mobile phone to text messaging to social media, lead generation from online portals whether Zillow, Realtor.com, or Facebook, sphere marketing and CRM from various vendors, and even training and coaching by telephone, webinar, and online learning systems.

She needs a broker only because state licensing laws and regulations require her to have a broker.

This radical independence and self-reliance of the agent lead to the NGB.

Traditional Brokerages Tried to Defend, Rather Than Adapt

It is important to remember that these changes occurred before the NGB emerged. It isn't as if mobile technology snuck up on the industry. Had the traditional brokerages adapted to the changing times, instead of trying to defend the status quo they had achieved, the story might have been different.

So why didn't the traditional brokerages see the trends and adjust?

There are a few reasons, which are relevant to us.

Change is Gradual, Until It's Not

First of all, it is easy to see the impact of technology on business models and viability after the fact with 20/20 hindsight. It's classic Monday morning quarterback play.

Even those brokers who saw the trouble ahead would have found it difficult to adapt. It required real sacrifice in the here and now for a potential gain in the future, which was and is never certain.

In real time, as things were changing, the potential impact of decisions is much, much harder to see. For example, it is asking far too much of a broker in the 80s and 90s to predict that the invention of the heavy, expensive, and unwieldy mobile phone would one day make his palatial office an albatross around his neck.

There are also black swan events, such as the collapse of the housing market that caught just about everybody by surprise. It was such a surprise that a popular Hollywood movie was made about the few people who saw it coming. The collapse devastated the industry up and down, left and right. Many brokerages were too busy trying to stay afloat to pay attention to investing in new technologies or changing business models to cope with the changing times.

Let's cut the traditional brokerages a break.

Change is Hard

Investment is inherently difficult to do. Foregoing present-day utility (pleasure, money, whatever) for future gains is never an easy thing to do. Otherwise, everyone would always be in shape.

Even those brokers who saw the trouble ahead would have found it difficult to adapt. It required real sacrifice in the here and now for a potential gain in the future, which was and is never certain.

The business model of the traditional brokerage was a sweet deal for quite a long time. In a very real way, the old school brokerage has elements of the Platform business model:

- Audience (buyers and sellers who had to contact a broker to find out what was for sale)

- Matchmaking (connecting those buyers and sellers to agents)
- Providing core tools and services (office space, office equipment, technology, training, etc.)
- Setting rules and standards (mandatory oversight, as well as business policies and rules)

Technology advances eroded each of these elements, but adapting in advance means sacrificing revenues, profitability, market share, and all of those wonderful things that brokers were enjoying, for the possibility of a stronger position in the future.

We cannot underestimate the difficulty of changing an existing business model, especially if those changes require mass layoffs of managing brokers who are responsible for recruiting all of the agents in an office. Those relationships walk out the door when the manager leaves. Maybe you're in a better position five or ten years out, but you've gone belly-up in the meantime.

The history of business is filled with corpses of once-great companies that saw the change coming, tried to react, but found they couldn't change fast enough. Kodak comes to mind, as does Xerox. And oftentimes, even if you do see a challenge coming, and you *do* try to adapt to it, inertia and business realities make that difficult. See, e.g., Microsoft and the famous Internet Memo.

Again, let's cut the brokerages some slack.

Their Focus Was Elsewhere

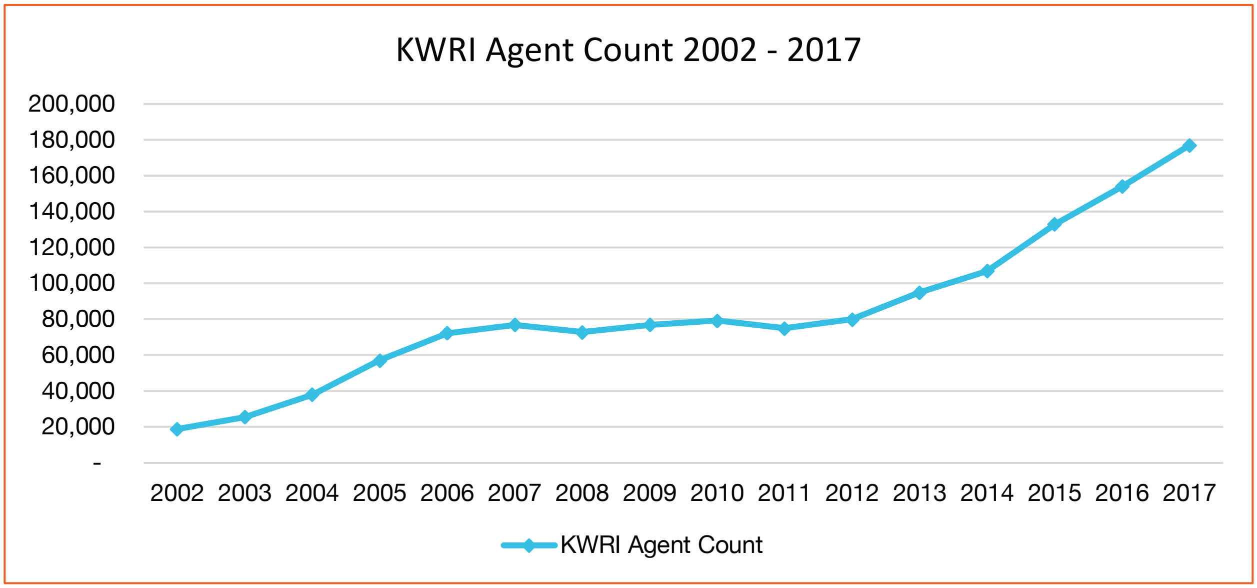
Furthermore, traditional brokerages didn't see the NGB coming because the NGB was riding in the wake of the monster that was Keller Williams.

From 2002 to 2017, Keller Williams grew its agent count by an eyepopping 837%, from 18,800 to 177,000.[12] It isn't as if the number of REALTORS increased by 837% during that time. In fact, in 2002, there were 876,195 REALTORS. In 2017, there were 1,308,616

[12] The information comes from a series of press releases by KWRI over the years. It may not reflect accurate year-end agent counts for each year.

REALTORS.[13] That means that KWRI went from 2.2% of the REALTOR population to 13.5% during that period.

All of those agents came from somewhere, and that somewhere was usually other traditional brokerages.



dn't

be bothered with small startup companies who seemed like a gimmick play that couldn't possibly survive financially. Without realizing that NGBs are structured financially, operationally, and legally to make ends meet on very thin margins, and to become very profitable at scale, it is difficult to take them seriously.

For example, here is Richard Smith, then CEO of Realogy, during the FY 2012 earnings call:

> Now that said, there are nontraditional commission models like those that offer their agents 100% commissions and then they pay for all related expenses. Those will continue to perform as they have in the past. So I don't see them gaining share or doing anything particularly attractive or interesting in the market.

But in the 10-K for 2012, we find this passage:

[13] https://www.nar.realtor/membership/historic-report

> We also compete for the services of qualified licensed independent sales associates. **Some of the firms competing for sales associates use a different model of compensating agents, in which agents are compensated for the revenue generated by other agents that they recruit to those firms**. This business model may be appealing to certain agents and hinder our ability to attract and retain those agents. [Emphasis added.]

While Smith didn't specifically name Keller Williams, there was no doubt in anybody's mind who he was talking about. And in other earnings calls, Smith specifically named Keller Williams as the threat. All the while, he was dismissing the 100% commission brokerages.

In retrospect, at the same time that traditional brokerages were trying to deal with the competitive threat that was Keller Williams with its cap on commissions, profit sharing, unique culture focused on training, and agentcentric mindset, the NGB grew under the radar.

Agent Expectations

Finally, the expectations of the agents have really changed in the past ten years or so, leading to the explosive growth of the NGB. How could it not have changed, when the agent today is really a Brokerage of One?

As Sam DeBord of CB Danforth puts it, agents today understand what their options are – and there are a lot of options. It used to be three big franchises in town, and the agent picked one. Part of the reason, he believes, is that just as the internet brought information about housing to consumers, it brought information about brokerage options to agents.

He further believes that the NGB is far more efficient for the agent. "It's not more efficient to sit in traffic, drive to the office, and be constantly distracted by other agents," he said. "We have agents who ask us, 'Do I have to come into the office? That's a deal-killer for me.'"

Wendy Forsythe of HomeSmart felt that where the NGBs are ahead of the curve is in understanding what it is that agents still demand from their brokerage: community, support and engagement from the managing broker, legal and regulatory compliance, and basic training and technology (with the freedom to use whatever the agents want from outside the company).

The NGB works today because agent expectations have fundamentally changed. What they want and need from a brokerage, from a broker, are no longer what they once wanted and needed. Technology is the reason for many of those changes, but there may also be a social and cultural shift going on.

Top producers want someone to have their back with legal issues, but they don't necessarily want the rest of the brokerage experience – i.e., weekly sales meetings, training, etc. There are some who are willing to contribute to the office as a whole, but most are solely focused on building their own businesses. These agents tend to belong to mastermind groups with other top producers in markets across the country, so they aren't sharing their ideas and successes with agents in their offices. You can't ever forget that the agent sitting in the next cubicle is a potential competitor.

I had a variety of personalities in my top producers. Some required extra attention. They were super fun, had great personalities, did a ton of deals, and clients loved them. But they were disorganized, could not negotiate effectively, did not know the mechanics of transactions, could not handle conflict or criticism, and were highly emotional. Every office has these top producers; I was hardly unique among managing brokers.

Others never asked for help, but I would check in with them regularly to show appreciation and to see what we could do to bring more value. There is a lot of ego-stroking that happens. If I wasn't doing it, I could bet that another broker was, because that was what I was doing with top producers at other brokerages whom I was gently recruiting. I always wanted to be the first call if she had an issue at her current office, which meant that I had to keep top producers happy at my office.

Technology changed the expectations of agents. With so many tools and systems available at a low cost to individual agents, there is very little that she can't buy on her own. And agents don't often want to tie themselves to company tools in the event they decide to leave – protection of client data is important. No one wants a former broker contacting their clients.

Because agents are generating a vast majority of their own leads through portals or personal relationships, the brokerage has lost leverage that it once had. No one signs up for "floor time" (sitting in the physical office to meet walk-in consumers) because potential clients call agents directly from yard signs, online ads, or via referrals from friends and family.

The Curious Case of eXp

I mentioned above that while I use the example of eXp Realty as a poster child for eliminating occupancy costs that I did not consider them an NGB. Let me discuss why.

eXp is often described as a "cheaper version of KW" without the heavy emphasis on a culture of semi-spirituality. eXp is not a 100% commission, fee-only model like the NGB. That means that eXp also has to care about Sales Volume.

At the same time, eXp embraces many of the elements of an NGB: no physical office, centralized and specialized operations, and a culture of freedom. eXp's stock-based compensation tries to emulate the appeal of stock options that technology startups offer employees.

It's like a hybrid of KW's business model with the low-cost structure and cultural mindset of an NGB.

(IN THOUSANDS)	Q2/2017	Q3/2017	Q4/2017	Q1/2018	Q2/2018	YOY
NET REVENUES	38,981	48,106	47,490	61,963	130,543	234.9%
COST OF REVENUES	34,741	43,291	42,611	55,702	118,119	240.0%
GROSS PROFIT/COMPANY DOLLAR	4,240	4,815	4,879	6,261	12,424	193.0%
GROSS PROFIT MARGINS	10.9%	10.0%	10.3%	10.1%	9.5%	(12.5%)
G&A	5,693	11,987	13,230	15,689	12,989	128.2%
PROFESSIONAL FEES	318	224	368	592	597	87.7%
SALES & MARKETING	349	380	542	646	710	103.4%
TOTAL EXPENSES (EXCL. COST OF REVENUE)	6,360	12,591	14,140	16,927	14,296	124.8%
NET INCOME/(LOSS)	(2,147)	(7,781)	(9,328)	(10,696)	(1,887)	
AGENT COUNT	3,800	4,900	6,511	9,290	11,856	212.0%

Agent count grew 212% YOY, and revenues are up 235%. And yet, its gross profit margins are down 12.5% from what was already a thin 10.9% to an even thinner 9.5%.

Keep in mind that eXp revenues include a number of fees, just like an NGB:

- $50 monthly fee
- $420 University Tuition fee per year
- $250 transaction fee for the 20 transactions after cap; $75 after that
- $30 E&O insurance fee per sale until $500 (17 sales)
- $25 broker review fee

Just the monthly fee alone should have dropped almost $1.8 million to the topline revenues in Q2, and of course those fees are not split with the agent. eXp also reported 19,903 closed transaction sides for Q2. At $250 per transaction, the transaction fee alone should have been almost $5 million in revenues that are not split.[14]

Yet, gross margins are down. (To be fair, its net loss decreased, so that's a plus.)

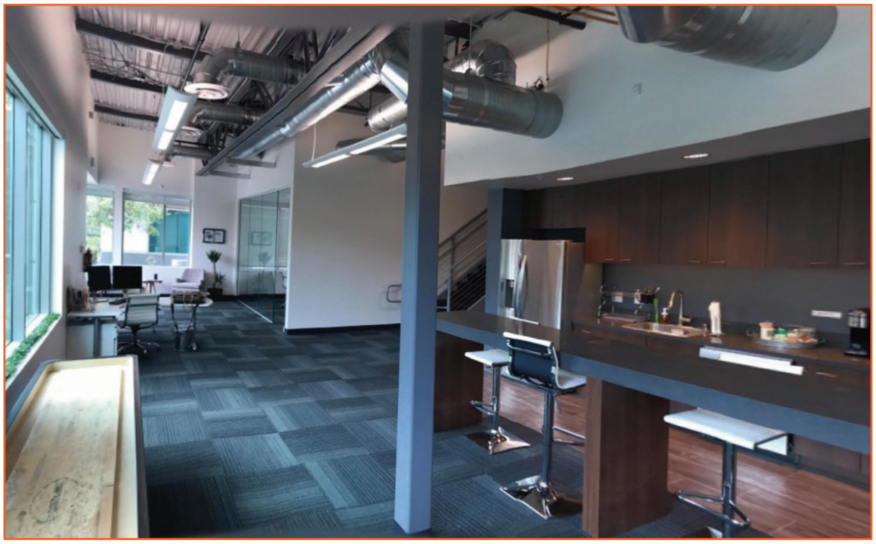
In effect, eXp's financials look more like that of a 90/10 split brokerage whose margins are heading south, instead of an NGB whose margins should be impressive with over 11,000 agents. Recall from above that according to Steve Murray, an NGB could see net profit margins in the 10-12% range.

Perhaps future earnings calls will bring some light to this odd situation. But until then, it's difficult to know where to classify eXp. The difficulty is exacerbated because…

[14] The vast majority of real estate agents do not do 20+ transactions per year. The average is closer to 6 transactions in a year.

The NGB is a Real Estate Coworking Space

Our thesis is that the NGB is best thought of not as a real estate brokerage but as a **niche coworking space company**.



Big Block Realty office in Carlsbad, CA

The NGB doesn't really function like a real estate brokerage as we have come to understand them. It works more like a coworking space that makes money from space rental disguised as membership fees and features community and culture as key value propositions.

One way to think of the NGB is to think of it as a cultural movement.

Khorramian talked about how his company specifically modeled itself after coworking spaces:

> The overall environment of our office is very modern, progressive, very "Google." We have games, foosball, lounges, etc. The energy is different. Doesn't feel stiff, doesn't feel corporate. It feels more like WeWork. It's collaborative and open, and we do a lot of social events.

In my hometown of Greenville, a coworking space called OpenWorks exemplifies this approach. From their page titled "Our Purpose, Mission, Culture and Vision":

> **Culture / Values / How**
>
> Open is more than part of our name, it is our ethos and we take cues from successful open-source communities.
>
> We operate an open, lean co-work space that is well-informed because our members operate and steer the bus.

The NGB is, in effect, the adoption of the coworking space movement and philosophy into the real estate industry. The NGB is a broker, legally speaking, who does do all of the things a broker is required to do. And the agent recognizes that the broker is doing those things because he is required to do them by the government.

Outside of that limited role, however, the NGB is actually operating a coworking space for real estate agents.

NGB as a Cultural Movement

One way to think of the NGB, then, is to think of it as a *cultural* movement, rather than a new business model.

Traditional brokerages emulate lawyers and bankers. They want to convey solidity, conservatism, stability, expertise, maturity and a respected (and respectable) brand image. The broker is somewhat like the senior partner at a firm, a parent figure who takes care of the agents in a somewhat paternalistic fashion.[15]

[15] One interesting note here is that while agents are mostly female (67%), brokers are mostly male (54% and 52% of Broker-Owner and Selling Broker-Owner, respectively). But interestingly, 72% of Manages who do not sell are female, while only 29% are male. This chart is from the 2017 NAR Member Profile report.

EXHIBIT 5-3 GENDER OF REALTORS®, BY FUNCTION

(Percentage Distribution)

		LICENSED AS		MAIN FUNCTION IN FIRM							
	All REALTORS®	Broker/ Broker Associates	Sales Agents	Broker-Owner (without selling)	Broker-Owner (with selling)	Associate Broker	Manager (without selling)	Manager (with selling)	Sales Agent	Appraiser
Male	37%	42%	33%	54%	52%	35%	29%	51%	34%	72%
Female	63	58	67	46	49	54	72	49	67	28

In contrast, NGBs emulate startups and WeWork. They want to convey an image of being hip, cool, smart, fun, and offer a non-coercive environment. Where management styles in traditional brokerage can be top-down, the NGB tends to be very horizontal, even upside down: the broker is part of a customer service call center operation, while the agent is free to do whatever she wants as long as it's legal.

The culture that this difference in economic impact between a top producer and an average producer creates is different.

Traditional brokerages always have stars: the top producers who do the most volume. They get the higher splits, the nice offices, and the brokerage often pays for their expenses from admin support to marketing.

The NGB has very little preferential treatment of top producers since everything is transaction fee based. Top producers who do a huge number of transactions pay more and likely receive some favoritism, but the economics are simply different.

For example, look at the difference for a traditional brokerage between the top producer and a mid-level agent:

	TOP PRODUCER	**MID-LEVEL**
Transactions	20	10
Volume	$10 million	$5 million
GCI (@2.5% commision)	$250,000	$125,000
Office Split (@80/20)	$50,000	$25,000

This is a very simplified view since many top producers demand higher splits, and they often pay desk fees, etc. But it is clear that a traditional brokerage has a significant incentive to cater to the top producer and keep her happy.

Now look at the same two agents in an NGB:

	TOP PRODUCER	MID-LEVEL
Transactions	20	10
Volume	$10 million	$5 million
GCI (@2.5% commision)	$250,000	$125,000
Broker Fee Income (@$495 per)	$9,900	$4,950

On a percentage basis, the top producer pays twice as much as the mid-level. But in actual dollars, the difference is fairly minimal. With such thin margins, there's very little room for special treatment of any top producer.

The culture that this difference in economic impact between a top producer and an average producer creates is different. In a traditional brokerage, the top producer is like a superstar athlete. In an NGB, the top producer is merely one among equals, exactly the same as a successful member of a coworking space might be.

The social aspect of coworking cannot be underestimated, so we should see the NGB become more and more about social connections and community, and less and less about legal requirements and compliance.

How NGB Could Evolve

Given this insight, we might think one step ahead and consider how the NGB might evolve into the future. We look not at real estate brokerage, but at coworking spaces for hints as to how trends in that industry might translate into real estate.

According to a 2018 blog post by Cushman & Wakefield, there are eight key concepts for 2018 and beyond for coworking spaces. Of them, three are of particular interest to us.

Cross-Pollination

Cushman Wakefield writes:

> **Design Drives Engagement**. The best coworking spaces are immersive and offer captivating design, delivering

> unexpected elements of fun and comfort. Coworking design benefits businesses by encouraging interactions between customers, which can lead to more formal business relationships. For example, WeWork and Convene have recently introduced design innovations like coffee shops, amenity floors, retail pop-ups, educational institutions, and fitness centers.

And the next point:

> **Connectivity Drives Growth and Innovation**. Coworking spaces generate heightened connectivity amongst different businesses, presenting an opportunity for innovation to occur at the intersection of different disciplines and mirroring the balance between intellectual harmony and tension made famous at AT&T's Bell Labs in the late 19th century. This historic project employed tactics that would later influence the coworking movement by housing "thinkers and doers" in a shared space, emphasizing an open door policy, and encouraging close physical proximity of diverse professions.

As of today, the NGB-as-coworking-space is much more focused and concentrated on real estate agents. It makes sense given that the NGB is positioned as and legally is a brokerage.

However, an obvious evolutionary path is to separate the legally-mandated brokerage functions (compliance, contract review, etc.) into merely a tenant of a larger Real Estate Coworking Space concept that invites in related businesses at first, and everyone else second.

For example, mortgage brokers, title and escrow companies and real estate lawyers are a natural fit with real estate agents. But they will find it difficult to go sit in a real estate brokerage office as competing brokers and their agents will not do business with such "in-house" mortgage, title, escrow and legal professionals. However, if the physical office were to be more of an explicit separate-from-the brokerage Real Estate Coworking Space, that problem could be overcome.

A slightly different approach could be one in which an NGB simply invests in a local coworking space company that serves the business community as a whole, and then moves in as a tenant.

The goal would be to foster that interaction between customers and the connectivity between disparate sectors serving real estate to help create opportunities for innovation and partnership.

Less Broker, More Social

Another trend that Cushman & Wakefield writes about is "space-as-a-service":

> **A Hotel, a University, and a Home.** Coworking operations blend the best aspects of a boutique hotel with the social atmosphere of a university and the comforts of a home, under the mantra of "space-as-a-service," as WeWork's Head of Product Research Josh Emig describes. Providing personal amenities, hospitality services, individualized spatial design, IT services, and social programming is a critical factor in differentiating coworking brands and one that allows members to solely focus on their professional endeavors.

Although we have seen that the contemporary agent is a Broker of One, she still has personal needs. Personal amenities, childcare, concierge services, social events, private gyms for working out, etc. are all valuable services that agents would pay for. This approach also fits in perfectly with the design innovations such as coffee shops and retail pop-ups described above.

The social aspect of coworking cannot be underestimated, so we should see the NGB become more and more about social connections and community, and less and less about legal requirements and compliance. In a way we could see the evolution of the NGB where the transaction fee pays for the required legal compliance work, while the monthly fee pays for the value of the coworking space.

More Physical, Less Virtual

The interesting upshot here is that the NGB, which began by ruthlessly cutting out office space and occupancy cost overhead (with eXp and the new Keller Williams Virtual Brokerage being poster children for that movement) could end up becoming far more *physical* in the next stage of evolution.

Virtual happy hours are not particularly happy. People do have a need to be with other people, and that can best be accomplished even in today's digital world in person.[16]

The twist here is that the work itself of buying and selling real estate will remain largely virtual. There is no longer a need for a physical office for a Brokerage of One real estate agent. But there is a need for physical space for socializing, networking, and connecting.

When the NGB figures out how to offset the cost of physical space by "renting" space not just to real estate agents but to the general business community, I believe we will see a migration towards the explicit coworking model of well-designed technology-friendly spaces with plenty of amenities.

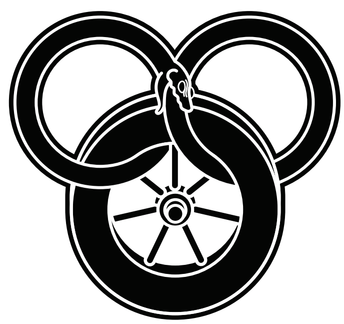
The future then, is physical not virtual for the NGB. For the traditional brokerage, the future is first virtual in order to catch up… which is why Keller Williams is launching a Virtual Brokerage. Then go physical again. By then, the NGB might have moved on to something else altogether.

[16] The strongest argument for this need for "IRL" (In Real Life) interaction is EXPCON 2018 Conference in New Orleans, which is being put on by, you guessed it, the virtual brokerage eXp Realty. The office might be virtual, but the conference will be in the flesh.

- ❦ -

The Wheel of Time turns, and ages come and pass, leaving memories that become legend. Legends fade to myth, and even myth is long forgotten when the Age that gave it birth comes again. In one Age, called the third age by some, an Age yet to come, an age long past, a wind rose in the Mountains of Mist. The wind was not the beginning. There are neither beginnings or endings to the turning of the Wheel of Time. But it was a beginning.

- *The Eye of the World*, Robert Jordan



Decide. Act.

RECOMMENDATIONS: BROKERAGE

If the NGB is the near-term future of real estate brokerage, what should brokerages be doing today?[17]

If You Can't Beat 'Em…

The first answer has to be to copy as much as what works for the NGB. Realogy has already taken some steps, by experimenting with the likes of Coldwell Banker Danforth. KW is taking steps with its Virtual Brokerage concept.

However, in trying to emulate the NGB, it's important to keep in mind exactly how and why they work. It's not just about cutting costs; it's about cutting the right costs in the right way.

Because of the difficulty of changing one's core business model, along with the risks that come with it (see above about firing a managing broker who has all of the relationships with the agents), if you were looking to copy what works for the NGBs, I would proceed with a particular emphasis on the following initiatives.

[17] Please note that our position at 7DS Associates is that a Redfin-style employee-based model that combines Platform characteristics with an iBuyer-type of linear business is the ultimate long-term future of the industry. But over the next 5-10 years, the NGB is likely to be dominant absent dramatic changes in the legal and regulatory environment – e.g., California's *Dynamex* ruling affecting 1099 independent contractor status.

Back of House, Not Front of House, Technology

The first place is to stop obsessing about the consumer or agent-facing front of house technology. That battle has been long lost, if it was ever a fight to begin with.

According to Steve Murray, Real Trends conducted a series of meetings and studies for a group of broker-owners in the Atlanta area. Their finding was that nothing in technology can give a broker a sustainable competitive advantage.[18] However, that study was more interested in front of house technology, since competitive advantage is defined in terms of recruiting and retention of agents, rather than efficiency and productivity of the staff.

Instead, focus more on back of house technology that would make your W2 employee paid staff more productive. This is not radical change: this is incremental productivity improvement. The company does not need to be overhauled, nor does your business model need to be changed. You don't need to lay off managing brokers and disrupt your company culture.

Making your staff more efficient and productive, however, is a good first step. It's low-hanging fruit.

Get Rid of Front of House Technology

Wherever possible, emulate the NGB in not paying for front of house technology. Whatever system you the broker provide should be the baseline, cheap but still gets the job done type of technology. Agents are going to use whatever technology they want anyhow. Let them. Don't worry about agent adoption.

If recruiting an agent and she demurs about your lack of some sexy technology platform, consider cutting your split instead and telling her to go buy it herself with all the extra money in her pocket. It works for the NGB; no reason why it couldn't work for you.

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[18] We might ask whether that's true if the brokers spent enough money to develop cutting edge technology, but once again, brokerages are not technology companies.

Steadily Cut Costs

One of the things that NGB operators all brought up was that traditional brokerages waste a lot of money on unnecessary expenses.

We've already discussed the physical office space issue at length, but what I left out above was that the NGB executives all thought large fancy offices had more to do with the broker-owner's ego than with business operations.

Sam Khorramian of Big Block mentioned a local traditional competitor who does things like sponsor Little League teams and big community events. Unless he can directly trace ROI from such sponsorships, he doesn't do them, believing that they are more about burnishing the social status of the broker-owner or the managing broker rather than improving the business. Let agents sponsor Little League and local events, not you.

Centralize and Specialize

The next step is to centralize and specialize as much as possible. This is the most difficult step because it does require overhauling your organization, disrupting existing relationships, and changes to your business model.

But there are intermediate steps you can take. For example, if your local managing broker's true value is in recruiting and retention of the agents in his community, perhaps think about setting up a centralized compliance team who can handle the legal and regulatory issues, freeing up your managing broker to focus on recruiting. Eventually, perhaps the local broker could transition into a full-time recruiter role.

Certainly corporate functions such as accounting, marketing, HR, and technology can all be centralized and removed from the responsibilities of local office staff. But recognize that this will not be an easy change. Many local managing brokers have been in their positions for years, if not decades, and have been operating what amounts to private fiefdoms. You need to get them to buy in to the vision, so they will accept reductions in their staff, power, and budgets.

Skip Ahead: Brokerage

It may actually be smarter strategically to jump ahead. You don't out-Walmart Walmart. Trying to catch up to the NGBs who have already spent years setting up their systems and operating with their lean cost structures could be difficult, if not impossible.

As a general matter, we are not fans of playing catchup with the competition. We think it's better to skip ahead and try to become what they will ultimately become or become their nemesis.

Don't try to out-Walmart Walmart; become Amazon instead. Or closer to home, what if back in the 90s, 00s and the 10s, Realogy had chosen to become eXp Realty instead of trying to catch up to KW?

If you've read the August Report on Platforms, you know that one path is to attempt to become The Platform – or an important Market Maker on the Platform. Realogy's recent announcement that they are launching an iBuyer service is in this vein. If you have the resources and access to capital, this is an excellent path to explore.

If you've read some of our other work, you know that we believe the ultimate future of brokerage is a W2-based model with strong technology, control over the consumer experience, and some sort of a linear business that offers real value to consumers. Think Redfin here, but on a smaller scale as more of a local niche boutique, since you have neither the 26 million monthly uniques that Redfin.com has nor the billions in capital to which Redfin has access.

Skip Ahead: Real Estate Coworking Space

The alternative might be to skip ahead and become an actual real estate coworking space.

The NGB has brought concepts from the coworking space world into real estate, fusing it with brokerage. A viable strategy, then, is to skip ahead to the future of the NGB and become a real estate coworking space company instead.

I wrote above:

For example, mortgage brokers, title and escrow companies and real estate lawyers are a natural fit with real estate agents. But they will find it difficult to go sit in a real estate brokerage office as competing brokers and their agents will not do business with such “in-house” mortgage, title, escrow and legal professionals. However, if the physical office were to be more of an explicit separate-from-the brokerage Real Estate Coworking Space, that problem could be overcome.

It may be possible to explore whether the “brokerage” portion of the business – that is, the legally required oversight and compliance functions, as well as the agent support and advisory functions – could be performed by one business unity that is one of many tenants in the overall coworking space business.

For larger brokerages with large and fantastic physical offices, this may actually be a very viable and valid path forward. Turn your weakness into a strength if you can.

Make Smart Acquisitions

For larger companies and for national franchises, I recommend making some smart acquisitions instead of trying to build this from within.

The culture of the NGB is radically different from the culture of traditional brokerage. Wendy Forsythe of HomeSmart, who came out of the traditional brokerage world, talked about the learning curve for her when she joined HomeSmart. She had to let go of everything she knew about the brokerage business.

Rather than spending millions or even hundreds of millions acquiring front-of-house technology companies, it might be a better investment to spend the money acquiring successful NGBs with dynamic leaders who know what they’re doing, so they can teach the rest of the people throughout your organization what they need to know.

CONCLUSION

The Next Generation Brokerage is a force that is rapidly gaining momentum and may represent the short- and medium-term future of the brokerage industry. And yet, they are poorly understood within the industry, because so many people dismiss them as "100% shops" who do nothing for the agents in exchange for zero percent of the commission.

After some 20,000 words in this report, I hope that you will not make that mistake.

The NGB is not merely low-cost. They are high-value and low-cost, embracing an agentcentric model of brokerage that is built around the contemporary real estate agent who is a Brokerage of One. They have taken the original Re/Max model, modified by Keller Williams, and have taken it to the next level.

In effect, just like Keller Williams brought organizational and personal development concepts from the campus para-church movements such as Intervarsity Christian Fellowship and Campus Crusade for Christ into the real estate industry, the NGB has brought concepts and culture from the rapidly growing coworking space movement into the real estate industry.

Most of you who have read this already know that you have to respond to the competitive pressure of the NGB, or at least of eXp, who is growing as rapidly as KW once did. You can choose to respond, or be forced to respond, but respond you will.

My hope in writing this report is that at least now, you have some more insights on how to respond because you know how the NGB works, why the NGB works, and what the likely evolution of the NGB is.

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