

THE CALIFORNIA BROKERAGE INDUSTRY SOLUTIONS REPORT

DECLINE IN BROKERAGE
VALUE AND PROFITABILITY

THE INDEPENDENT CONTRACTOR
VS. EMPLOYEE CONUNDRUM, AND
AGENT TEAMS

THE MULTIPLE LISTING
SERVICE (MLS): TOO MANY?
TOO SMALL?

PROFESSIONALISM OF THE
REAL ESTATE AGENT



CENTER FOR
CALIFORNIA
REAL ESTATE

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Background

The Center for California Real Estate (CCRE) is an institute founded by the CALIFORNIA ASSOCIATION OF REALTORS® (C.A.R.) dedicated to intellectual engagement in the field of real estate. Its mission is to advance industry knowledge and innovation with an emphasis on convening key experts and influence-makers. CCRE reflects C.A.R.'s increasing role in shaping the future of the industry by advancing innovative policy solutions and active dialogue with experts and industry stakeholders. The Association works in conjunction with 102 local associations of REALTORS® throughout the state, as well as with the National Association of REALTORS®. Serving nearly 195,000 members statewide, C.A.R. provides a wide array of products and services to meet its diverse member needs. Additional background on CCRE and C.A.R. can be found at centerforcaliforniarealestate.org.

Author

Rob Hahn, Managing Partner, 7DS Associates & well known industry consultant

Published By

CALIFORNIA ASSOCIATION OF REALTORS®

Leslie Appleton-Young, Senior Vice President and Chief Economist, CALIFORNIA ASSOCIATION OF REALTORS®

June Barlow, Senior Vice President and General Counsel, CALIFORNIA ASSOCIATION OF REALTORS®

Sara Sutachan, Vice President of Industry Relations & Strategic Initiatives, CALIFORNIA ASSOCIATION OF REALTORS®

Anne Framroze, CCRE Director, and Senior Vice President, CALIFORNIA ASSOCIATION OF REALTORS®

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INTRODUCTION

CEO Summit: The California Solutions Report

At the 2016 California REALTOR® Expo in Long Beach, C.A.R. held its first CEO Summit.

Thirty-six brokerage leaders – owners, CEO’s, managing brokers – from across the spectrum of real estate firms in California were invited to participate in a unique session whose goal was to help solve some of the biggest problems confronting the real estate industry. These brokerage leaders represented some of the largest companies in the state, as well as smaller yet among the most innovative and most nimble of companies. Collectively, they represented almost 20,000 agents.

Over the course of four hours, these leaders discussed, debated, and ultimately voted on suggestions for the real estate industry in California to deal with some of its biggest challenges. This report outlines the issues that these brokerage leaders were asked to consider, and their suggestions for further action.

The four issues tackled were:

- Decline in Brokerage Value and Profitability
- The Independent Contractor vs. Employee Conundrum, and Agent Teams
- The Multiple Listing Service
- Professionalism of the Real Estate Agent



Rob Hahn

These are among the biggest challenges that confront the real estate industry both in and outside of California.

This is a report of a group of CEO's expressing their own opinions and possible solutions. While all opinions and perspectives are welcome, please note that these propositions have not been approved by any C.A.R. Committee or its Board of Directors.

Note from Rob Hahn:

To be perfectly candid, I was nervous about the session going in. Real estate is famous for its comity, even between fierce competitors. It was no certain thing that the individual men and women gathered in the conference room would speak their mind. It would be far easier and far less politically risky to say nothing or repeat tired old platitudes.

The group of brokerage leaders exceeded every expectation we had. They were energized, engaged, and enthusiastic from the get-go. They expressed their opinions in a strong, yet civil, way that led to frank and open dialogue about the challenges and the issues. And mixed in with the seriousness of the topics and the discussions were laughter and camaraderie that are rarely seen at a real estate conference.

FOUR KEY CHALLENGES

- Decline in Brokerage Value and Profitability
- The Independent Contractor vs. Employee Conundrum, and Agent Teams
- The Multiple Listing Service
- Professionalism of the Real Estate Agent

DECLINE IN BROKERAGE VALUE AND PROFITABILITY

ISSUE:

For decades real estate brokers have seen their profitability decrease. There are a few reasons for the decline.

- First, the agent-centric model pioneered by RE/MAX in the 70's changed the balance of power between the broker and the agent.
- Second, technology advanced.
- Third, the Internet disintermediated the broker from the lead-generation value chain.
- Fourth, the rise of the Agent Team has further eroded profit margins.

As a result, for most companies, the actual brokerage practice is a low-margin business (sometimes, a loss leader) that exists primarily to funnel leads into the far more profitable ancillary businesses of mortgage, title, and escrow when legally permissible to do so.

The challenge is what, if anything, different segments of the industry can do to help solve the profitability problem.

SUGGESTED SOLUTIONS:

The brokerage leaders identified two institutions – organized real estate (specifically C.A.R.) and the brokerage itself – as key drivers of change. Their suggestions are:

What Should We Do?

1. Provide counseling to brokerages on ancillary services

Provide counseling to brokerages on how to operate ancillary services, such as title, escrow, and mortgage.

There are quite a few legal pitfalls on operating ancillary services, from RESPA (Real Estate Settlement Procedures Act) to Consumer Financial Protection Bureau (CFPB) regulations, that govern affiliated business models in mortgage and settlement procedures. Some of the largest brokerages have legal counsel that can guide them on how to set up such ancillary service operations, but most of the small-to-midsize firms do not. That is one area where C.A.R., and

ACTION ITEM RECAP

- Provide counseling to brokerages on ancillary services
- Provide consulting to brokerages on exit strategies
- Provide consulting services for agents who are retiring or ill to take over “book of business”

particularly its legal staff, can make a positive contribution to brokerage profitability.

Furthermore, the breakout group felt that C.A.R. could tap into the knowledge base of its broker members on how to operate ancillary services in the most effective, most profitable way, while living up to the requirements of the National Association of REALTORS® (NAR) Code of Ethics.

Something that was brought up during discussions was that there are huge differences in how ancillary services are handled between Northern & Southern California. C.A.R. would need to be sensitive to the different business environments and business cultures surrounding these ancillary services as it goes forward with research and best practices recommendations.

2. Provide consulting to brokerages on exit strategies

Another suggestion is to provide consulting to member brokers on a variety of exit strategies. Exit strategies include sale of the company, mergers and acquisitions (M&A), and succession planning.

In some cases, selling one's brokerage to another firm is the ideal exit strategy. In other cases, M&A in which two brokerages merge, with one broker taking a more passive role, is the best strategy. And finally, for smaller boutique brokerages, having one or more of the agents take over the company is an excellent exit strategy as well.

While not directly related to profitability issues, such consulting would naturally address profitability concerns since valuation would invariably take the brokerage operations' profitability into account.

3. Provide consulting services for agents who are retiring or ill to take over “book of business”

Finally, directly related to the issue of *brokerage* exit strategy is the issue of *agent* exit strategy. And this exit is directly related to brokerage profitability.

In many cases, a brokerage will see its revenues and profits plummet if one of its top agents leaves the business, whether through retirement or illness/incapacity/death. One of the advisory services that brokerages could use from C.A.R. is on how to handle that transition of a top agent out of the business.

What Should Brokers Do?

1. Expand into property management

One concrete suggestion is for brokerages to explore opportunities in property management. Diversification of real estate services provided is typically a good strategy in a cyclical business.

2. Define company culture

One of the insights from the group, comprised of successful brokers from across the spectrum of size, is that profitability and company culture are inextricably linked. Gone are the days when a brokerage could offer in-house color copiers or group buys in the local newspaper as a reason to join the company. As a result, a company's culture is one of its most valuable recruitment tools. The “why” of a company, why it exists, why agents should want to be a part of it, is a critical part of a company's value to its agents. It should be used to recruit, retain, and engage managers, staff, and the agents.

3. Adopt a Limited Function Referral Office (LFRO) agent recruiting model for retiring or ill agents or non-active agents. Monetize referrals & LFRO's fees. Statistic from a large MLS: year end 2016, 31 percent had not closed a single side.

Another suggestion for improving brokerage profitability is to adopt the Limited Function Referral Office (LFRO) model for agents who are heading towards retirement or not fully active status for reasons of health, family, or life demands. Many of these agents have a sphere of influence, but cannot or do not wish to work full time to adequately engage those prospects or indeed to service them adequately if they become a client.

A brokerage would be wise to investigate processes and procedures for monetizing those referrals and LFRO fee arrangements for the benefit of those less-active agents and for the company itself.

4. Provide exit strategy counseling to agents in order to transition their “book of business”

Finally, brokerages should be thinking about providing consulting and counseling to agents who are heading towards a transition, whether due to retirement, illness, or life circumstances. This is particularly fruitful for longtime established agents with a book of business (whether sphere, farm, past clients, or other) who are planning for retirement in the next few years.

From a brokerage perspective, losing an agent's book of business to a competitor is a hit to revenue and profitability. Assisting those agents in transitioning their business to another agent within the same company, therefore, is in the brokerage's best interests and aids in keeping profitability up.

ACTION ITEM RECAP

- Expand into property management
- Define company culture
- Adopt a Limited Function Referral Office (LFRO) agent recruiting model for retiring or ill agents or non-active agents. Monetize referrals & LFRO's fees. Statistic from a large MLS: year end 2016, 31 percent had not closed a single side.
- Provide exit strategy counseling to agents in order to transition their “book of business”

THE INDEPENDENT CONTRACTOR VS. EMPLOYEE CONUNDRUM

And Agent Teams

ISSUE:

For a few years now, the issue of whether a real estate agent is or should be an independent contractor or an employee has been a matter of grave importance to California brokerages. Multiple lawsuits, from *Bararsani v. Coldwell Banker* (which has been settled) to *Cruz v. Redfin* and others, have raised the issue in California's courts.

That the plaintiff's bar, regulators and labor unions in California – and nationwide – stand on the other side of the independent contractor or employee issue creates a political dynamic where a legislative or lobbying solution may not be ideal.

Add to that volatile mix the issue of agent teams, which continue to gain in popularity in the industry, and the issue becomes even more important. While brokerages often skirt close to the edge of the various elements that distinguish an employee from an independent contractor (e.g., directing where, when, and how the job is to be performed), agent teams often go way over the edge. To use just one example, in most agent teams, the buyer agents on the team are required to use the team's Contact Relationship Management (CRM) system, as the clients all belong to the team, rather than to the buyer agents individually.

Should a salesperson bring a lawsuit seeking to be classified as an employee not of the brokerage but of the agent team for which she works, there is a risk she could win treatment as an employee. The consequence of that to the brokerage and to the industry is as yet unknown, but is not likely to be a positive one for the status quo.

Threshold Question:

The first question this group addressed was

whether independent contractor status was more of a curse than a blessing. On the one hand, independent contractor status means cost savings for the brokerage for having an agent affiliated with it. With a W-2 employee, each agent would cost the brokerage in terms of minimum wage (even if drawn against commission), possible overtime, benefits, unemployment insurance, expense reimbursement, and so on and so forth. On the other hand, the lack of control that brokerages have over their agents is the direct result from having independent contractor status in the first place. Further, salespersons by and large prefer the fluidity of independence and lack of control by the broker.

After discussion and debate, the group decided that keeping the independent contractor status of real estate agents is preferable, and that the suggestions are geared mostly towards preserving the current state of affairs.

What Should We Do?

1. Legislative action to preserve status

Keep up the pressure on the legislature to preserve the status of real estate agents as independent contractors.

2. Safer independent contractor agreement

Develop an independent contractor agreement form that is "safer" for the brokerage. Given the lawsuits in *Bararsani*, *Cruz*, et al., the brokerage leaders felt that it would be beneficial for C.A.R. legal staff to review the independent contractor agreements that brokerages use when bringing an agent on board. [NOTE: C.A.R. currently publishes two independent contractor agreements (ICA-BA and ICA-NA), one with an extensive individual arbitration clause and one without. These are the

published forms C.A.R. publishes for independent contractor relationships under the current law.]

3. Training on broker supervision

Along with an improved, safer independent contractor agreement, the group felt that C.A.R. should develop a series of courses and materials for brokers and managers on how to supervise agents as required by California Bureau of Real Estate (CalBRE) regulations while still maintaining their status as independent contractors.

California law provides a safe harbor that echoes the U.S. tax code, yet recent court challenges (but not final decisions) call the independent contractor status into question notwithstanding both the standard agreement and the California statutory framework. The plaintiff's bar is pushing to expand this area. Although various governmental entities and the courts use a variety of multi-pronged tests to determine whether someone is an independent contractor or an employee, none have made a specific ruling as it relates to the real estate industry's historical practices. State and federal agencies vary as to the test applied and

the courts have varied depending on the area of law in question. For example, California and federal tax law has a clear, easily met test for such items as withholding, disability insurance and unemployment insurance and even includes language relating to "all statutory purposes."

Accordingly, C.A.R. should develop and offer training to brokers and managers on how to supervise the agent to fulfill the requirement of the real estate license law while avoiding practices that run counter to the independent contractor status in areas that are being challenged as outside those parameters.

4. Develop contingency plan

At the same time, the group recommends that C.A.R. establish a working group to study the issue of independent contractor vs. employee status. If a court decision, a change in legislation, or a similar government action ends up classifying real estate agents as employees for most brokerages, it could be catastrophic to the brokerage industry in California.

ACTION ITEM RECAP

- Legislative action to preserve status
- Safer independent contractor agreement
- Training on broker supervision
- Develop contingency plan

Accordingly, the issue should be immediately studied to consider developing a contingency plan both for organized real estate – since Associations and MLSs are likely to see a massive drop in subscriber numbers – and for brokerages who need to transition quickly to a new business model.

While organized real estate fights to preserve the status quo, should there come a time when the industry needs to pivot, C.A.R. should lead the way with action plans for the industry.

What Should Brokers Do?

1. Make team leaders responsible

Because the group also dealt with the issue of independent contractor vs. employee for the agent teams that are becoming more and more popular, one concrete suggestion of the group is for brokerages to revisit their relationship with the agent teams around this issue.

Most agent teams today are likely conducting the team so there is a risk of failing the “control test” or “economic reality” or “ABC” test that some California or federal agency or future court may apply, as they both control and direct how the agents who are “on the team” working under a team leader have to conduct their businesses. In some cases they may not satisfy the straightforward three-prong state and federal tests. If so, the agents may not be independent in some of the tests currently used by government agencies and by the courts.

Therefore, the strong recommendation of the group is for brokerages to consider educating agent team leaders on the issue of independent contractor vs. employee status, and to the extent allowed by law attempt to hold them either responsible for

compliance with employee rules for those in that classification, or responsible for the costs associated with their agents being classified as employees not of the brokerage but of the agent teams themselves.

2. Training

Train the teams and managers to make sure they understand the ramifications of a team in terms of employer/employee requirements for team leaders and managers. Have a resource for them to get good counselling on employment law issues and to know how to either comply with applicable laws or design business models that minimize risk as to misclassification of independent contractors, including transaction coordinators.

3. Education

Educating lower producing agents so they know that a certain level of production is necessary to retain them as employees if the law ever reclassifies them.

4. Elimination/standard of practice for all

Consider eliminating teams altogether as the broker will likely bear some risk if their practices result in an employment structure within the team.

5. Asset management systems

Have an asset management system so if the law changes, there is an adequate structure for personal risk and, where possible, corporate risk. In the worst case scenario, consider if bankruptcy occurs, how to emerge with a different business model. Position the brokerage to survive or minimize such a catastrophic turn of legal events.

6. Contingency plan

Have a contingency plan in the worst case scenario such as which agents could transition to employee status, how to create a new model and the business terms of such an arrangement. Evaluate whether the cost/risk of keeping nonproductive agents is still warranted.

ACTION ITEM RECAP

- Make team leaders responsible
- Training
- Education
- Elimination/standard of practice for all
- Asset management systems
- Contingency plan

THE MULTIPLE LISTING SERVICE (MLS)

Too Many? Too Small?

Issue:

The MLS has been a major issue for many years, but some of its problems have become particularly acute as of late.

Broadly speaking, there are too many MLSs, which are too small and too territorial, and which are too undercapitalized to be able to offer the level of products and services that Participants and Subscribers require.

At the same time, too many MLSs have governance structures that could be described as broken. All too often, local politics drives decisions, rather than what is best for the brokers and agents who rely on the MLS for their day-to-day business.

What Should We Do?

1. Advocate for the separation of the MLS and the Association of REALTORS®

The first step in addressing the problem of the MLS is to recognize that it is the interrelationship between the MLS and the Association that causes many of the problems. On the one hand, the MLS is the number one – and often the only – reason why people join the Association. That may bring dues revenues to the Association, but seriously hurts the Association’s efforts to raise the bar on professionalism. On the other hand, the Association provides the MLS with what may be the only one in a particular geographic area.

The solution is privatizing the MLS. The Association should spin off the MLS as a separate for-profit corporation with two classes of shares. Voting shares would be restricted to Associations and brokerages, while investor shares (which pay

dividends, have economic value, and can be freely traded, but do not carry any voting power) would be open to all.

The Association would continue to receive an income stream from its ownership of the MLS and benefit from the number of Subscribers to the MLS, without having them become “members-in-name-only” of the REALTOR® Association. The MLS would be forced to compete in the marketplace, no longer protected by the geographic boundaries of the local Associations, and be able to operate more fully as a business entity, rather than as one driven by association politics.

2. MLS Governance – Create Representative Council of Brokers

One of the most broken features of the current system of MLS governance is that the various stakeholders – and in regional MLSs such as CRMLS, the various local Associations – seek representation and a voice in the conduct of the MLS by seats on the Board of Directors.

This creates a Board that is more involved in association politics and less business-minded. Directors are appointed or elected to the MLS Board based on association-related political influence, rather than their expertise in guiding a corporate business.

At the same time, seeking representation via the Board is *self-defeating* since every Director of a corporation owes a fiduciary duty to the corporation itself, rather than to his or her “constituents.” Each Director is told before every Board meeting that they have to “take off their other hats” and put on the “MLS Director hat” and only consider what is in the best interest of the MLS itself.

The suggestion is to advocate that all MLSs within California create a separate body with *no formal legal power* (to avoid it being classified as a fiduciary) but with enormous real power of influence. The group called it the “Council of Brokers” (Council) – a natural name given that all of the group members are brokers or managers.

The Council would be a fully representative body, whose members owe no duty to the MLS corporation and can therefore represent their constituents to their maximum ability. By deferring questions of importance to the real estate industry – such as the rules and policies of the MLS, or product selection – to the Council, the constituents actually gain *more power* to influence the direction of the MLS.

Simultaneously, the actual corporate Board can be restructured to be a corporate Board of Directors, whose job is to maximize shareholder value, and to ensure that the MLS is operated *efficiently as a profit-making business*.

3. Broker Profit-Share MLSs should profit-share with brokers on a pro-rated listing basis (alternative – activity)

Another suggestion from the group is that the MLS should incorporate formal profit-sharing with its Participant brokers.

The MLS was created by, for, and of the Participant brokers. It does not exist and cannot exist if the brokers do not submit listings to it and other brokers use those listings to bring buyers to properties for sale. The logic, then, is that the MLS makes money on the backs of its Participant brokers.

As long as the MLS is operated as a non-profit as is often the case today, the issue of profit-sharing is

moot, since there are not (or should not be) any profits to share. However, post privatization, the MLS is charged with generating significant profits for its shareholders. In that scenario, profit-sharing with the participant brokerages whose intellectual property and use of the MLS system enables the MLS to generate a profit at all is only just.

For example, if an MLS generates \$5 million in profits in a given year, it would share 10 percent (\$500,000) on a pro-rata basis with Participants based on listing count (or transaction count). A broker who has put 10 percent of the listings into the MLS during that year would receive \$50,000 or 10 percent of the profit sharing pool, as an example. It should be noted that this kind of profit-sharing is not novel. NASDAQ is one organization very similar to a MLS in terms of creating a marketplace from the collective efforts of its members which offers a profit-share to its members based on trading activity.

The only unsettled point for the group was whether the profit-share should be on a pro-rata per-listing basis, or on a pro-rata per-transaction basis. The logic of using per-listing is that the MLS is a compilation of listings, and therefore, the listing broker (whose intellectual property the listing is) should be compensated in a profit-share. The logic of using a per-transaction approach is that the MLS generates much of its revenues from the activities of buyer agents and buyer brokers. Ultimately, the former won the vote, but there remains a strong minority vote for the latter position.

4. Brokers should give up control over pricing of the MLS

Critical to the entire effort of privatization is the requirement that brokerages, as Participants, whose agents are paying subscribers of the MLS,

must give up control over pricing of the MLS service. The group discussed the fact that the principal reason why the MLS products and services are so outdated and so poor is that the MLS Board regards the MLS as a “member benefit” and seeks to keep costs as low as possible. Much of that is in response to brokerage demand that the price of the MLS be kept as low as possible.

If the MLS is transformed into a profit-making venture, which pays out dividends to its Association and Broker shareholders (as well as non-voting investors), the Participant brokers of the MLS must give up control over pricing of the MLS and allow that price to “float” against market.

The group recognized that such “market pricing” likely means that the cost of the MLS would go up, substantially in some cases. But they were of the opinion that an agent who cannot afford a \$50, \$75, or even \$100 a month for the MLS is likely someone who should not be in the real estate business in the first place unless they were just starting their careers. And in such cases, many of the brokers in

the group felt that they might decide to subsidize those costs for the first year or two to give the agent a chance to establish a sustainable business.

The Ideal MLS

Since brokerages cannot do very much to affect the MLS, the group spent time brainstorming about the “Ideal MLS.” These are their suggestions:

1. Business-to-Business (B2B) Marketplace without boundaries

The role of the MLS, from the perspective of brokerage leaders, is that of a well-ordered, well-regulated Business-to-Business (B2B) marketplace. The offer of Cooperation and Compensation (C&C) is at the heart of the MLS, as it assures buyer brokers that they will get paid for their time, energy, and resources. But it is not the only feature of a B2B marketplace.

The rules and policies of the MLS which govern the behavior of Participants and Subscribers are nearly

ACTION ITEM RECAP

- Advocate the separation of the MLS and the Association of REALTORS®
- MLS Governance - Create Representative Council of Brokers
- Broker Profit-Share
MLSs should profit-share with brokers on a pro-rated listing basis (alternative - activity)
- Brokers should give up control over pricing of the MLS

as important as C&C as they provide the order and expectations of the behavior of market participants. And no B2B marketplace could function without accurate data that professionals require to make sound business judgments, and advise clients on market trends and proper pricing, and an effective compliance system that guarantees accuracy.

None of those are different from the core mission of the MLS today. The difference for the Ideal MLS would be that artificial boundaries and borders imposed by the Association are removed. Brokerage leaders felt very comfortable with allowing the MLSs – converted to privatized profit-seeking business ventures – to compete anywhere and everywhere they could, as competition can only be good for the customer: the brokers and agents who use the MLS every day.

2. Free of politics

The Ideal MLS would operate as a straightforward business enterprise that provides products and services at a price the market would bear, and make decisions based primarily on business concerns, rather than on political considerations of the Association world.

Privatization, coupled to governance reform that separates the Board of Directors as a true corporate board, while creating the Council of Brokers as the representative body, allows for most business decisions to be made free from association politics. Even major decisions like mergers, acquisitions, sale of assets, or major financial decisions would be made by the Board and the CEO based on business concerns.

As businesspeople themselves, the brokerage leaders were enthusiastic about that change in the culture and philosophy of the MLS.

3. Reasonable & enforced rules

If the Board becomes a corporate board concerned primarily with financial, legal, and operational issues of the MLS as a business entity, the Council of Brokers becomes the primary body that sets the rules and policies of the MLS. These rules and policies, after all, govern the behavior of market participants and the market participant themselves are best suited for determining what kinds of rules and policies they want to set for themselves.

For example, how the MLS should handle new construction listings (many of which do not have standard photographs like a resale listing would) is far more of a rules/policies issue than a financial or legal one. Accordingly, the workings of the Council through what is essentially a *legislative* process would yield rules that are far more reasonable to the average Participant.

The Ideal MLS takes those reasonable rules and enforces them so as to guarantee both the orderliness of the marketplace as well as the crucial data accuracy that Participants count on.

One benefit of the privatized MLS model, in which different MLSs compete for business without artificial geographical boundaries, is that the process of compliance might take on a vastly different character.

For one thing, fines are no longer a key non-dues revenue source, since the MLS itself has pricing power. That means the MLS might take far more of a supportive, customer-service oriented approach to compliance (“Hey, just noticed that your photographs are out of compliance – you might want to change those so they show up properly on websites.”) rather than a punitive one (“Your photos are out of compliance; please pay

\$100 fine for violating the rules”) that is more appropriate for a government with subjects than for a business with customers.

4. Non-competitive with brokers

Last, but certainly not least, the brokerage leaders all felt that a major benefit of privatization of the MLS, which gives it pricing control, is that the MLS would cease most, if not all, of the things it does that anger its Participant brokers.

One reason for all of the MLS products and services that compete with what a brokerage provides for its agents is the need for non-MLS subscription fee revenues. Being unable to raise prices, even though the cost to the MLS goes up every year, means that the MLS has to find alternative ways to generate revenues. Those kinds of product offerings, whether fees charged to brokerages to access their own data, agent websites, transaction management platforms, or some other technology product or service, are intended to create an income stream for the MLS.

Without the pressure of non-MLS subscription fee revenues, many an MLS would find it far easier and more attractive to its customers (the Participant brokers) to drop products and services that compete with the brokerage. Perhaps the MLS might invest more into the basic MLS platform software as that would allow the MLS to raise prices in a competitive manner, rather than investing in things like transaction management systems in order to generate non-MLS subscription fee income.

THE IDEAL MLS

- Business-to-Business (B2B) Marketplace without boundaries
- Free of politics
- Reasonable & enforced rules
- Non-competitive with brokers

PROFESSIONALISM OF THE REAL ESTATE AGENT

Issue:

In 2015, the D.A.N.G.E.R. (Definitive Analysis of the Negative Game Changers Emerging in Real Estate) Report from NAR stated as its A1 Danger:

Masses of Marginal Agents Destroy Reputation

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

The industry has known about this problem, and has talked incessantly about different ways of “raising the bar” for many years. And yet, it remains the single biggest problem of the real estate industry.

If you ask a working real estate agent in the trenches every day what the biggest challenge of working a transaction is today, the typical answer is “the agent on the other side.” Far too many agents do not return phone calls or messages, engage in unethical behavior (such as not presenting an offer, or presenting it in a biased manner, so as to double-end the transaction), and act unprofessionally, which could harm both the buyer and the seller.

Recent developments in the province of British Columbia (BC), a common-law jurisdiction much like the U.S. whose real estate regulatory environment and real estate practices are very similar to those of the U.S., suggest that the problem of incompetence and unethical behavior is not simply an inside-baseball issue for real estate. In BC, media reports of abusive practices by REALTORS® combined with lack of oversight by both the Association and by the government regulator (Real Estate Commission) have led to sweeping changes that ended decades of self-governance for the industry.

The brokerage leaders in this group faced some of the toughest issues. Here are their recommendations.

What Should We Do?

1. Create Regional Associations of REALTORS®

Investigate creating Regional Associations of REALTORS® (AOR) particularly in sparsely populated rural areas of the state. The intuition is that some of the smaller Associations without the resources may not be able to offer training to their members, nor are they able to enforce Code of Ethics violations effectively.

2. Create statewide standard for discipline

Discipline for Code of Ethics violations is left up to each local Association, which results in an uneven patchwork of discipline. Should we create a statewide uniform standard for discipline for various offenses against the Code of Ethics and mandate uniform enforcement? Conceptually, this is similar to sentencing guidelines for judges to ensure that similar crimes carry similar penalties.

3. Increase fines & mandate them

Another issue at the Association level from a Code enforcement standpoint is that the fines for violations are too low. This is particularly true when the possible gains from Code violations are tens of thousands of dollars in commission income. A \$500 fine is just a slap on the wrist and many serial violators consider fines to be “cost of doing business.” Fines should be increased for more serious violations, and include escalators to punish serial violators to create real disincentive for unethical behavior.

Furthermore, similar to the statewide standard for discipline above, the fines should be mandatory. Leaving discretion for enforcement up to the local Association often means that a Code violator strikes a deal either to pay less than the fine amount or to have the fine be waived in exchange for promises of good behavior or warnings which are never made public.

4. Exposure: name them and shame them

The lack of publicity is a real issue that could be easily addressed.

On the one hand, violations of the Code need to be made far more transparent than they are today. Ethics violation hearings are often secret and the results are never publicized. Serial violators can pay fine after fine, be disciplined time and again, but the consumers and other professionals have a very difficult time finding out about such issues.

Create a “Wall of Shame” naming those who are found guilty of violating the Code of Ethics. Such publicity should be online so that consumers and professionals both can easily search for violations, see the disciplinary action, and understand the reasons why there was a violation and why the discipline fit the misconduct. Such disciplinary entries should be written in plain English suitable for consumers to understand, avoid industry jargon and legalese, and be publicized to consumers so they know where to go to find out if a REALTOR® they are considering is an ethical one or not. Nothing is quite as powerful, the group believes, for dissuading unethical and incompetent behavior by REALTORS® than publicity – particularly to consumers.

C.A.R. currently publishes the names of those members disciplined by a local Association who

were given a fine, reprimand, suspension or expulsion. These are published but available to members only on car.org/mlspro/coeviolators/.

5. Three strikes rule

Furthermore, the group recommends that organized real estate study the feasibility of a “three strikes rule” for Code violations. Certain ethical provisions, especially those that deal with consumers and the public, ought to include in escalating discipline, the mandatory expulsion from the Association after a certain number of violations. As with California’s “three strikes” rule for dealing with felonies, the group believes that serial violators of the Code should be expelled after three violations of certain provisions of the Code.

Currently, local panels are supposed to take all past history of violations in mind when determining discipline. They can check all past violations from all associations (since the system started in 2012) in the central discipline database maintained by C.A.R.

6. Exposure: positive examples

On the other hand, positive examples of professionalism and ethical behavior are also not publicized enough. Organized real estate should provide a series of websites and campaigns to tell the positive stories of REALTORS® going “beyond ordinary commerce” as many routinely do. Negative publicity will teach REALTORS® and their consumers what not to do. Positive publicity will teach them what to do, and what to expect from a REALTOR®.

The “Wall of Shame” type of websites discussed above could easily have a section for “Wall of Fame”

highlighting those REALTORS® who routinely provide excellent customer service and live up to the ideals of the Code.

7. Agent ratings

Related to both of the above, negative and positive exposure, is the suggestion that organized real estate investigate some sort of Agent Rating platform for both consumers and professionals. While a variety of agent rating sites are now available, it was felt that an Association sponsored platform would be received as unbiased.

There is a need to make it difficult to “game the system” should some form of agent ratings be introduced.

8. Increase continuing education (CE) in first four years as a licensee and increase requirements to maintain a real estate license. Also, require individuals to be involved in a minimum number of transactions before getting licensed as a broker.

Both of these suggestions involve organized real estate’s advocacy and lobbying efforts, since organized real estate does not control California’s license laws or regulations. However, we can influence legislators and regulators to increase requirements to maintain a real estate license.

Accordingly, we should argue for increased CE requirements for new licensees (first four years) and seek higher requirements to maintain a real

ACTION ITEM RECAP

- Create Regional Associations of REALTORS®
- Create statewide standard for discipline
- Increase fines & mandate them
- Exposure: name them and shame them
- Three strikes rule
- Exposure: positive examples
- Agent ratings
- Increase continuing education (CE) in first four years as a licensee and increase requirements to maintain a real estate license. Also, require individuals to be involved in a minimum number of transactions before getting licensed as a broker.

estate license. We should also argue to restrict being licensed as a broker to individuals who have conducted a minimum number of transactions to ensure that those who have a responsibility and the authority to supervise salespersons know what they are doing themselves.

What Should Brokers Do?

- 1. Exposure – take broker supervision seriously**
- 2. Establish a mentorship program and require new agents to participate**

One suggestion for brokers and managers is to require a mentoring program for newer agents in their companies if they are not already providing one. Different companies will have to figure out a mentorship program that makes sense for both the mentor and the protégé, but most mentorship programs offer a small override on the protégé's commissions for the mentor.

From an ethics standpoint, the mentor and protégé should be treated as a single unit by the brokerage, as the whole concept is that the mentor is taking responsibility for the actions of the person he or she is training. Screening experienced agents who wish to be a mentor for a solid foundation on ethics – especially as pertains to consumers and the public – is essential.

- 3. Hire an effective operations manager**

Most office managers are tasked with growing the business of the entire office, which includes recruiting, retention, oversight, conflict resolution, and even coaching/training. Their days are filled already with critical tasks.

One way to ensure greater professionalism on the part of agents is to hire an Operations Manager who can both teach and support the agents with the day-to-day tasks involved in servicing a client. Simple but necessary tasks like promptly responding to inquiries and questions from clients and from other professionals go a long way towards establishing a solid foundation of professionalism. An Operations Manager can help the agents get into good habits and support them directly if the agents get too busy.

A good Operations Manager would also be able to spot trouble or identify problem agents and work with the office manager to train, discipline, or remove unprofessional or unethical agents before they become real problems.

- 4. Require agents to use an in-house transaction coordinator**

Many busy agents use a transaction coordinator (TC) to ensure they do not miss anything in the midst of a transaction that profoundly impacts their clients' lives. However, there are still some agents who refuse to incur the cost of a TC. The group believes this is a case of penny-wise and pound-foolish.

A brokerage should require the usage of a TC by its agents, to make sure that client service delivery is as smooth and professional as possible, with minimum surprises. For those agents whose business volume does not warrant the hiring of a personal TC, the brokerage should strongly consider hiring a TC at the office level to support those agents.

5. Create and enforce a company culture of competence

The Brokerage Profitability group discussed the importance of company culture for profitability. It is equally as important, if not more important, when it comes to professionalism.

One of the most important things a brokerage can do is to create and enforce a company culture of professional competence and ethical behavior. From the owner to the office manager to each and every agent who carries that brokerage's brand on her business card, the common agreed understanding must be that competence and ethics are absolutely required of every individual.

That means the brokerage has to be willing to enforce that culture, even if it comes at a cost. Far too many brokers and managers overlook a lapse in professionalism if it is a top producer who is doing it. The temptation to treat star agents who are responsible for so much production and profit differently is completely understandable, but brokers *must resist the urge*. Making exceptions for stars creates a culture among the agent ranks that the company merely pays lip service to ideals of competence and ethics.

It is also important that brokers and managers be less forgiving of lapses in professionalism. Each and every lapse must be called out and the agent held accountable in some way, even as a teachable moment, so as to reinforce the overall culture of professionalism. That does not mean severe punishment for small violations, but it does mean not ignoring a small problem because it is small.

A phrase that was used in the discussion and the presentation is "cadence of accountability," which refers to a company culture in which everyone is committed to professionalism and takes those

steps as a matter of routine habit. The office manager does oversight as a routine matter, and agents respond routinely as well.

6. Positive reinforcement

A recommended best practice for creating and maintaining a company culture of professionalism is constant reinforcement by positive examples. Agents and managers should be encouraged to highlight professional behavior, whether their own or the agents on the other side of a deal. Professionalism should not be perceived as merely rules and prohibitions and restrictions; it can be messaged as something that truly helps an agent's business and burnishes her reputation and makes her feel great about herself.

Tell stories during office meetings. Publish positive examples on company blogs. Give awards not just for highest production but for examples of professional and ethical behavior.

7. Have agents bonded – carry their own errors and omissions insurance (E&O)

ACTION ITEM RECAP

- Exposure – take broker supervision seriously
- Establish a mentorship program and require new agents to participate
- Hire an effective operations manager
- Require agents to use an in-house transaction coordinator
- Create and enforce a company culture of competence
- Positive reinforcement
- Have agents bonded – carry their own errors and omissions insurance (E&O)

ABOUT THE ATTENDEES



2016 Attendees

The 36 participants in the CEO Summit and Solutions report were owners, CEO's and/or managing brokers from across the spectrum of real estate firms representing over 20,000 agents in California. They were from some of the largest companies in the state, as well as smaller yet among the most innovative and most nimble of companies. Thank you all for your participation.

John Aaroe, Founder/Owner, John Aaroe Group
Victoria Aguilar, Managing Broker, Nelson Shelton Real Estate
Robert J. Bailey, Owner/CEO, Bailey Properties Inc
Vanessa Bergmark, General Manager/President, Red Oak Realty
Rick Bonyadi, Owner, Hall & Chambers Real Estate
Matthew Borland, Managing Broker/Partner, Zephyr Real Estate
Wes Burk, Broker/Owner, Patterson Realty
Jack Burns, Owner, Security Pacific Real Estate
David Cabot, Chairman, Berkshire Hathaway HomeServices California Properties
Rich Cosner, Owner, Prudential CA Realty Rancho Cucamonga
Mark Dilbeck, CEO, Dilbeck Real Estate – Real Living
Wendy Forsythe, EVP, Head of Global Operations
Derf Fredricks, Managing Broker, The Real Estate Group
Danny Fredricks, Team Leader, The Real Estate Group
Andrew Greenwell, CEO, Venture Sotheby's International Realty
Phil Jones, Owner, Coldwell Banker Coast Alliance
Kevin Kay, CEO, Coldwell Banker Residential Brokerage SF-Peninsula

Bev Kendall, Executive Vice President of Operations and Broker of Record, RE/MAX Gold
Spencer Krull, Broker of Record, Teles Properties
Michael Mahon, President, First Team Real Estate
Preston Miller, Broker/President, Modern Broker Inc.
Bruce Mulhearn, Chairman/President, Berkshire Hathaway HomeServices Mulhearn Group
Penny Nathan, Co-Founder, President & CEO, Ascent Real Estate
Andy Nazaroff, President & CEO, Guarantee Real Estate
Gretchen Pearson, President/Owner, Berkshire Hathaway HomeServices Drysdale Properties
Mark Peterson, Managing Partner/Broker, RE/MAX Masters
Sam Rafeh, Owner/Manager, Century 21 Hilltop
Randy Rector, Owner/CEO, Evergreen Realty
Dennis Rosas, Co-Owner/Manager, Berkshire Hathaway HomeServices Mulhearn Group
James Sanders, Broker/Owner, RE/MAX Estate Properties
John P. Shamshoian, President, Realty Concepts
Bob Stallings, Broker/Owner, RE/MAX Real Estate Specialists
Chris Trapani, Founder/CEO, Sereno Group
Michele Williams, CEO, Star Real Estate South County

Moderators:

Robert Hahn, Managing Partner, 7DS Associates

Rob Hahn is the founder and Managing Partner of 7DS Associates – a strategy consulting firm specializing in creative solutions rooted in strategic analysis and data. Rob started in real estate at a specialized commercial real estate investment firm investing in airplane hangars. He moved on to Realogy, where he headed the interactive marketing for Coldwell Banker Commercial. Rob writes the well-known blog Notorious R.O.B., where he opines on topics in real estate, technology, marketing, and strategy through far-too-long posts. He is a prolific speaker at industry events, such as Inman Connect, T3 Summit, local, state and National Association events, as well as weddings and bar mitzvahs. He is a graduate of Yale University with a degree in Philosophy.

June Barlow, Senior Vice President and General Counsel, C.A.R.

June is responsible for settling the overall legal strategy for C.A.R. and its members and is responsible for the Legal Department. She manages the litigation involving C.A.R. and its subsidiaries and oversees the Legal Action Fund. C.A.R.'s Corporate Legal Division provides transactional, intellectual property, business and human resources, legal support for C.A.R. and its many subsidiaries, including a nationwide real estate forms software company. June holds a Bachelor's Degree of Science in Mathematics from Brigham Young University and a Juris Doctorate from Brigham Young University, J. Reuben Clark Law School.

Leslie Appleton-Young, Senior Vice President and Chief Economist, C.A.R.

Leslie directs the activities of the Association's Member Information Team. She oversees the analysis of housing market and brokerage industry trends, broker relations, and membership development activities. She is also closely involved in the Association's strategic planning efforts and is a well-known speaker in California's real estate community. She earned a Bachelor of Arts degree in economics from the University of California, Berkeley, and her Master's from the University of Pennsylvania.

Sara Sutachan, Vice President of Industry Relations & Strategic Initiatives, C.A.R.

Sara oversees industry relations, membership development and strategic initiatives for the Association. In this role she helps the Association establish vision, identify new and emerging opportunities and relationships and is responsible for implementing key strategic initiatives. Sara is closely involved in the Association's strategic planning efforts and is a well-known speaker in California's real estate community. Sara has a Bachelor's degree from California State University, Northridge in Business Administration with concentrations in Finance and Real Estate and a Master's degree in Economics from California State University, Los Angeles.



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