

Broker's Survival Guide: Building Ancillary Relationships

By:



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Introduction

“It takes 10 Real estate Transactions to equal the amount of profitability of 1 Mortgage Transaction” -*Chip Roach, Prudential Fox & Roach.*

Most real estate brokers have heard for years that ancillary service relationships are important to improving profitability. This white paper recaps some of this as background, but it also breaks new ground.

This paper:

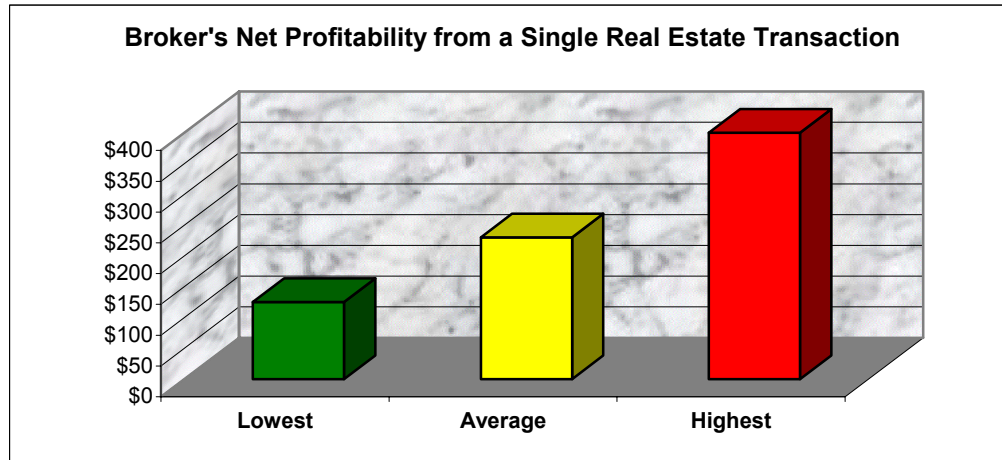
1. Explores reasons why brokers need to drive additional, non-core revenue (or start thinking about this revenue as core!)
2. Provides a 'how to proceed' section for building these relationships
3. Examines case studies of current brokers' Ancillary Service Relationships
4. Links to an online calculator (<http://www.callclareity.com/ancillary/>) for determining how much revenue each new product might produce based on that broker's number of transactions - or just how much a broker may be leaving on the table.

With margins becoming tighter in the real estate brokerage community, the revenue and consequent profitability derived from the brokerage fee alone will be insufficient to remain in business. Brokers' overarching strategy must include driving revenue from the attendant ancillary business', inclusive of: mortgage, title, home protection, etc. Creating partnerships, joint ventures, and/or marketing agreements with select service providers, supported by the resources of the brokerage company, will prove to be evermore imperative to retain profitability margins, business growth, and even survival.

Clareity believes that it is no longer just important to create ancillary relationships; it's now a necessity. To draw upon an analogy; it is commonplace in the fast food industry to offer a 'loss leader'. Burger King advertises and sells its Whopper sandwich for 99¢ expecting that the average customer will also purchase a soft drink and fries, two products with huge margins. The 99¢ Whopper, which can cost over \$1 to produce, is a loss leader. The real estate commission is quickly becoming the loss leader of the brokerage industry.

Adding product lines isn't necessarily just about the incremental expansion of profits. This change in the real estate industry could evolve Realtors and brokers the same way CPAs and life insurance brokers evolved into full-service Financial Planners.

Clareity's 2004 Broker study revealed the following:



Average net profitability per transaction: \$210 (lowest is \$105, highest is \$380)

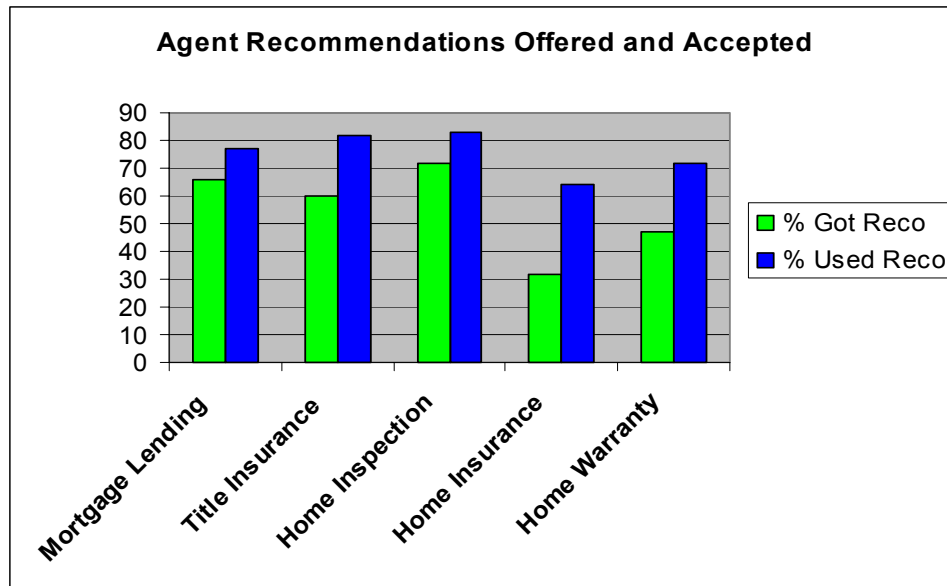
While the recent years have been record breaking in the real estate industry in terms of gross volume sales prices, real estate brokers have been experiencing razor thin margins. As illustrated above, the average broker's profitability is currently \$210 per transaction. Clareity's figure has also been validated by other recent industry studies.

Broker margins now are significantly lower than 20 years ago largely because of competition between brokers for high-producing real estate agents. To compete, brokers are offering good agents a larger share of the total commission, thereby increasing brokerage costs and reducing profitability. Competition also may mean paying a greater proportion of agent expenses. There are significant costs to run a full-service brokerage, and brokers continue to invest back in training and education programs, technology, information, marketing and other services for agents.

In the current condition where broker profitability increasingly depends on promoting "full service" brokerage and ancillary services, the one-stop-shop business model makes more and more sense. According to a new report released by NAR, clients are taking their agents' advice to choose up to one-half of their ancillary services providers. It simply makes sense that those service providers are subsidiaries and/or affiliates of the brokerage as frequently as possible.

There's a significant difference in the real estate services that homebuyers choose to use. Homebuyer behavior varies with the type of home purchased, the age of the home, and whether they are first-time or repeat buyers. What services they choose also depends largely on what their real estate agents suggest, which should be of considerable interest to brokers, franchisors, and service providers interested in strategic alliances. These services include: mortgage, title, inspection, warranty, insurance and others.

"Without ancillary businesses like mortgage and title, many big companies would shut their doors," says Steve Murray, co-editor of RealTrends newsletter. In a recent study reported by Mr. Murray, the following conclusion is evident: The majority of the time, when an agent makes a recommendation on which vendor to use, the consumer will follow that recommendation.



While the diagram above clearly indicates that consumers based their decisions on agent recommendations, the services used were rarely associated with the agent's firm. Service Offerings of Agent's Firm: Inspection = 8%, Title Insurance = 11%, Home Warranty = 9%, Mortgage = 13% Home Insurance = 6%, **None of These = 57%**. One can conclude that the brokers are currently uncompensated for the majority of referrals made to real estate service companies.

A recent poll, conducted by Harris Interactive, asked the following question: "If a company offered to set up a simplified, one stop shopping process for you in which they provided all required services, how strongly would you consider this process?" The answer: 82% of all buyers in the survey would strongly or somewhat consider this one stop shopping process. 47% would consider strongly 36% would consider somewhat and only 3% would not consider at all. One can conclude that if the broker had a relationship with ancillary service companies and could market the one-stop-shop concept through their agents, it would attract consumers.

Offering the consumer the one stop shopping they desire is not just about improving profits for the broker. Recent television commercials by Lending Tree point the way to one possible future: if real estate doesn't provide the one stop shop, service expansion will occur to meet consumer demand, and it won't happen on the terms set by the conventional real estate industry.

Explanation of Various Benefits

Increase profitability – Revenue Opportunity

Affiliated business joint ventures are becoming commonplace across the country. Properly structured to comply with RESPA requirements, they are completely legal. Typical partners are realty brokerage firms and title and escrow agencies. Whenever a sales associate of the realty brokerage brings in a home buyer for title and closing services, the work is performed by a joint venture controlled by the broker and the title

company. The joint venture partners generally split a large portion of the home buyer's title premiums between themselves, according to their ownership share in the joint venture.

For example, in a typical home settlement, just 15 to 20 percent of the premium might go to the title underwriter issuing the policy. The 80 to 85 percent balance would go to the joint venture corporation co-owned by the realty broker and the title agency, and be split according to their percentage stakes in the joint venture. Companies like First American, Stewart, and Fidelity are actively seeking partnerships similar to this construct.

There are many reasons for brokers to engage in ancillary service arrangements:

Service to clients - one stop shop

Over the past two years, it has become very clear that consumers are looking for the overly used, somewhat clichéd, yet accurate term: 'One stop-shopping experience'. All of the research that Clareity has conducted and examined suggests that consumers are driven by accessibility, ease of use and convenience. In the coming months, the industry will experience a shift toward a full service environment. If a competing broker is offering a full range of services, consumers will migrate to that offering. Consumers are looking for a singular point of contact, settlement service bundles, and simplicity in their transaction.

Clareity recently spoke with Jim Panepinto, President of Chase Venture Holdings. According to Jim, "Today's consumers desire a one-stop shopping experience. Strategic alliances offer real estate partners an innovative way to streamline the homebuying process as well as enhance the overall experience for their customers."

Market leadership position

As expectations evolve, Agents and consumers will seek out a brokerage that offers a full service experience. As brokers tie mortgage and title together through technology systems, market leadership will be defined as the ability to attract business through the diversity of the product offerings. By the end of 2005, Clareity expects to see the Transaction Management Systems move from the early-adoption stage to the early-majority stage on the technology adoption curve. This process will enable service providers to plug their automated ordering systems directly into the current flow of data effectively eliminating the redundancy of data entry. The consumer will be able to fill out an online application form once, and order multiple services.

Gain greater quality control into transaction activity

Brokers often experience a lack of oversight into the monitoring and regulation of processing transactions. Many times, brokers have little visibility into what activities are taking place by each agent. Brokers have very little control over the various files and documents that are critical to a successful transaction. If brokers have additional access into the lifecycle of a transaction, red flags can be identified and rectified immediately.

Gain a recruitment and retention edge over other brokers

Brokers are always seeking differentiation. Successful brokers leverage new processes and other differentiators early to attract Realtors. Agents are looking toward their broker and asking, "What have you done for me lately?" Providing a platform in which various services, such as mortgage and title, are available inside the office to the Agent will prove to be an incredibly value offering. Many agents do not want the responsibility of

making recommendations to their clients. Having ancillary services available for the consumers will relieve a burden currently placed on the agent.

Benefit experienced by offering one-stop-shopping	Broker	Agent	Consumer
Increased Profitability	✓	✓	
Increase capture rate, non-commission profit	✓	✓	
Gain a recruitment and retention edge over other brokers	✓		
Risk Management and Reduced liability for Errors and Omissions	✓	✓	
Increase customer satisfaction & gain repeat business	✓	✓	✓
Tie mortgage and title together through marketing and technology, single data entry.	✓	✓	✓
Reduced costs			✓
Gain greater quality control into transaction activity	✓	✓	✓
One Stop Shopping Experience	✓	✓	✓

The industry is buzzing with excitement around the development of joint ventures and affiliated business agreements. Many companies are eager to develop long lasting and meaningful relationships with traditional real estate brokers. First American is one of the leaders in offering specific realty-focused title insurance, closing, technology and information products and services to local and national realty firms. According to Steve Roney, President and CEO of First American Residential Group, “The foundation of our vision is centered on the real estate broker. We understand the significance of creating partnerships that will collectively enable us to provide the best product on the market and highest level of service to the consumer in an effective and technologically efficient manner. We have developed several systems that will enable a seamless transfer of data & information and we have made these proven platforms available to our broker partners.”

How To Proceed

The process of creating the appropriate business relationship with a service provider that meets a broker’s specific and unique needs can be daunting. For the more complex and profitable of these relationships, many real estate brokers have chosen to work with outside consultancy groups to facilitate the process. Clareity has years of experience in defining and creating business relationships and from that - we understand how complex the process can be. While the specific steps of the process are often times case dependant, it is Clareity’s goal to provide brokers with a roadmap that will ultimately lead you to a successful venture.

Creating an RFP

There are two distinct processes in developing an RFP (Request for Proposal). The first involves a description of the organization and the second involves a clearly articulated description of the expectations of the results of the RFP.

The more detailed and complete this document, the better the chances that the whole project will be successfully completed. It should come as no surprise that preparing a thorough RFP requires extensive research and a considerable investment of time. Before reducing an RFP on paper, an organization needs to clearly understand its objectives, capabilities, and service requirements.

'RFP' can also stand for 'Right Finalists for Project.' When sending out an RFP, a company will select candidates to participate and then review the responses. Brokers should never be looking to make a decision based solely on the RFP responses. They should instead select a few finalists and schedule detailed interviews or presentations. It is also important that the company leave enough time between the initial RFP offering and response deadline to process all of the responses.

Analyzing the Proposals

The RFP should yield several proposals that enable the brokerage to compare the company-fit of the service providers, means of evaluating products and services as well as the proposed financial terms in an 'apples to apples' manner. The proposal analysis should help the broker select finalists for further research and narrow down the list of those service providers invited to make presentations.

Presentations

Presentations give the service provider the opportunity to demonstrate the robustness and usability of their product or service. It also gives the broker the chance to ask challenging questions. It is very important that the broker not be completely swayed by a great demo and makes a decision based solely on how 'flashy' the offer looks. Keeping the service requirements and proposal analysis in mind when evaluating the presentations is paramount to making a good business decision. In building an enduring relationship, often times, the human side of the proposed venture is more important than the financial terms. It is also critical that the core cultures of the organizations align appropriately.

Final Selection

Using the information from the proposals and presentations, previous experience working with the selected vendors, service history and the perspective of references, the organization should be able to make a well-educated final service provider selection. However, it is important to leave the door open with the runner-up and retain an alternate plan during contract negotiations.

Case Studies

The following case studies explore unique efforts in developing business relationships across two different brokerages of varying size, location and objectives.

Realty Executives – Phoenix

Realty Executives of Phoenix is an impressive company:

- They are currently #1 in the market and have been for 31 consecutive years.
- They have 17 offices and 1,465 Agents
- They do \$6.5 billion in annual sales volume
- They complete approximately 30,000 transactions a year

John Foltz, President of Realty Executives in Phoenix, understood the value of developing an Affiliated Business Arrangement with the right Title partner and went through a tedious and thoughtful process to find the appropriate partner. From the onset, he identified the two most important qualities in a partnership:

1) This business is a relationship based business. John was looking to form an ABA with people that he had a solid relationship with. Respect and trust are attributes that are earned over time, and John was very clear that these qualities are more significant to him than any other aspect of a business venture.

2) According to John, “It was imperative that the cultures of our organization and the potential partner’s organization aligned properly. By that I mean the kinds of value systems that our potential partner uses need to be similar to the kinds of value systems that Realty Executive uses. It’s an empowered kind of management style here, it’s focused on agent success and it’s not a top-down, autocratically managed company.”

John led Realty Executives through a one year, in-depth selection process. A clear choice emerged and Realty Executives, the market leader in Phoenix, formed an ABA with First American Title Company. First American is also #1 in the Phoenix market and understood that it would need to continue to deliver the best product and the highest level of service. According to John, “I gradually discovered that First American’s culture aligned perfectly with the culture of our company.”

Realty Executives is a company of highly productive and fiercely independent entrepreneurs. Realty Executives’ current capture rate is between 24 and 25 percent on its’ 13,500 buyer sides per year. Realty Executives’ growth rate and penetration curve is on target to reach John’s goal of a 40% capture rate. “To get penetration, you have to do it by leadership, you can’t do it by management and you can’t force them,” John added, “Agents have a choice in their office, and we have not closed the doors to other title companies. We are so confident that our agents will see the value in the First American relationship, that we believe that they will choose the superior service, and so far, they have been.”

Prudential California Realty

Prudential California Realty (PCR) is one of the largest privately owned real estate companies in the country with over 140 offices in its network and approximately 3,800 agents in three states. The history of the organization dates back to 1887, when the original owners opened the first real estate office in the San Francisco Bay Area. The company has been in continuous operation for over 115 years and current President is only its’ seventh since 1887.

In 2003, Ed Krafchow, President and his partner David Cobo, CEO, began the process of developing a mortgage relationship. While PCR was already doing significant volume and producing profitable results with their in-house mortgage operation, the owners understood that in order to go from “good to great”, they would need a strategic partner. The first step in creating the relationship was to build an RFP. In Ed’s words,

“In the development of an RFP, there are two distinct processes. The first involves a description of your organization, a process that sounds simple, but is much like describing an elephant to a blind person. Clear articulation with precise specificity is a significant part of the rigor. The second part of the process is a description of your expectations of the results of the RFP”

After completing the RFP, PCR delivered it to ten large banks and/or financial services institutions. At the end of the requested time frame for response, of the ten, four of the ten institutions were eliminated due to lack of response or poor communication. Two additional responses were quickly dismissed leaving a total of four viable proposals. The process to narrow down the four finalists to two was a difficult task. Each organization had unique attributes and strengths. After making the necessary elimination, PCR was down to two exceptional organizations with very few demonstrable differences. The criteria used to select the final candidate were:

1. Brand strength
2. Footprint
3. People
4. Willingness to be flexible
5. Ability and willingness to support their growth
6. Construct of the business proposal

Ultimately, Prudential California Realty selected JP Morgan Chase. What did Ed, David and the PCR Executive team learn through this process? In Ed’s words:

1) “Brokers must use a more formalized approach to business, especially when dealing with entities that are considerably larger and possess greater resources. Whether you are meeting with a franchiser, a financial services company, or other vendor, large organizations appreciate a more formal approach. When you develop an RFP, you create clarity in the relationship by defining expectations. Further, it puts brokers in charge of the process, rather than being subject to the demands of a larger partner with more knowledge and greater resources.”

2) “Brokers must recognize the value that they bring to these strategic relationships, and understand the inherent potential of multiple relationships. Occasionally, real estate brokers are like home sellers – they overestimate the value of their business. More significantly, however, I believe brokers underestimate our value in relationship to the supply chain and its many other parties. See to engage those parties interested in a strategic alliance and identify those who can bring real value to the business, the relationship and your brokerage.”

3) “Brokers need to design their future business and their future in the business. Consolidation and exit cannot be the only game in town. Part of PCR’s strategy in this process is to wall ourselves from acquisition and begin running multiple lines of businesses. These include a three state-run real estate business, a mortgage business, a title business, and home warrant.”

Conclusion

Brokers' profit margins on the real estate commission dollar are likely to continue to erode and have little chance on improving. In 2004, brokers' overarching strategy must include developing partnerships, joint ventures and/or ABAs with selected service providers. Creating relationships makes sense on all levels. Consumers are demanding convenience and simplicity and those organizations that can assemble, market, and deliver one-stop-shopping have a measurable advantage over those that don't. If organized real estate does not provide the consumers what they are looking for, it is to be expected that the service will be provided from others and will not be structured to the advantage of traditional real estate businesses.

Creating partnerships, joint ventures, and/or marketing agreements with service providers, supported by the resources of the brokerage company, will prove to be evermore imperative to retain profitability margins and business growth.

NEW, FREE CALCULATOR

Find out how much new revenue your brokerage can generate by offering various new product lines by visiting: <http://www.callclareity.com/ancillary/>

About Clareity

Founded in 1996, Clareity continually strives to provide our clients a truly independent and unique perspective. Clareity has successfully executed a vast array of consulting projects for our clients, related to:

- IT Security Audit and business continuity assessment
- Development and analysis of RFPs for MLS systems, public records, broker systems, IP Telephony and transaction management systems
- Mergers and acquisitions and strategic alliances
- New product marketing and business plans
- Product integration specifications
- Competitive analysis
- Contract negotiation
- Project management and implementation assistance
- Quality assurance testing
- Market research including electronic and telephone surveys and focus groups

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