Power House: How Emerging Transaction Models Drive Greater Returns for Investors in Single-Family Properties

Stress fractures are starting to emerge in the U.S. real estate industry: the hidebound commission structure is increasingly out of line with international norms and with U.S. markets.

Selling a property is the moment of truth.

That's the moment when you learn the actual return on the investment you made.

Location. Maintenance. Improvements. Management. Marketing. Reputation. All of your efforts to build the value of that property boil down to the moment when you calculate the net return after you make the sale.

You have one last opportunity to maximize return: the point of sale. Selling costs, especially the listing agent commission, can have an outsized effect on your net return.

Buyers' agents charge about three percent for representing buyers. Listing agents also charge three percent for marketing a single-family house and managing the transaction.

That's about two points too much, according to ever-expanding research about the strategies for maximizing return on real estate investments.

Multiplied over an entire portfolio of single-family properties, that two-point differential can spell the difference between hitting ROI goals and missing them, between a successful year and a mediocre one.

Institutional investors are searching for solid, sustainable returns. The two points you can channel into returns can propel your firm's results ahead of competitors. That advantage positions you to satisfy investors, grow the business, and expand market share while boosting your firm's reputation.

All of that can come from the two points you gain by using an alternative to traditional real estate agents.

The two-point differential is a compelling advantage at the moment in the American real estate investment industry—but it won't be for long. A seismic shift is just starting, and that shift will profoundly and permanently realign U.S. real estate transaction platforms. New platforms providing smooth, seamless, and efficient property listing and marketing services are already equipping early adopters with greater return based on minimized selling costs of about one point. As these platforms become the industry standard, firms early to the revolution will have a commanding lead with investors.

The Crumbling Commission

Investors and regulators are scrutinizing all investment fee structures like never before. The real estate industry is a holdout, with traditional agencies grudgingly accepting smaller listing commissions only under pressure.

But change in other industries, and the resulting benefits to investors, is ratcheting up pressure on the real estate industry.

According to a 2016 international survey of real estate commissions conducted by UK firm Surefield, the U.S. model is "an outlier" that is out of sync with growth in gross national product. Commissions in northern Europe average about 1.7%, and commissions have been plummeting in formerly Russian and adjacent countries, by as much as 81%. The average transaction fee for home sales in the U.K., for instance, has remained unchanged for decades, at 1.5%.

Nearly all financial services are facing downward pressure on fees. Increasingly, customers are realizing that fees and transaction costs directly affect net return.

Transaction costs, especially commissions, are now an opportunity to strengthen return, and no longer considered a routine cost of doing business.

For example, intense scrutiny of fee structure is touching off major changes in the personal finance industry. Individual investors are rapidly shifting to low-fee index funds and away from higher-fee actively managed funds. The difference in return is compelling. In 2016, for the first time, holdings in index funds exceeded holdings in managed funds due to the greater cost efficiency of index funds.

The residential real estate industry will find it more and more difficult to justify its traditional model. Investors in residential real estate must thumbnail transaction costs at 10%—compared to 2% for managed funds and near-zero for index and ET funds. Highprofile investors are publicly challenging the traditional commission model. Kevin O'Leary, one of the stars of the investment reality show "Shark Tank," says traditional transaction costs alone make residential real estate a losing proposition in an era of slow appreciation. And listing agents' commissions depress returns of portfolios of single-family homes held by real estate investment trusts, according to Arixa Capital, a private equity analysis firm.

Barriers to Economies of Scale

The residential real estate market is one of the most fragmented in the country. With 22,580 real estate brokerages in the U.S. and hundreds of multiple listing systems, institutional property managers and investors have typically been all but forced to deal with a different agency for each market.

Fragmentation complicates the logistics of listing and communication, while imposing administrative costs as investment managers must keep track of activity and results for each broker.

Only a national residential broker with access to multiple listing services can offer true economies of scale that enable investors to control their own transaction and administrative expenses.

Early Indicators of Greater Returns

Real estate innovators are circling the traditional model. Discount brokerages, such as Redfin, are gaining market share, bringing down the average total commission to about 5.15% in 2015, according to industry consultant REAL Trends. But platforms built only for consumers don't address investors' need for efficiency and scale. Consumer-oriented platforms don't support large-scale reporting, analysis, and interfaces with related field and property management services.

As the residential real estate values start to move beyond recovery to net gains, research overlooked in the market crash becomes newly relevant and new challenges to the commission structure are emerging.

A 2008 working paper by the National Bureau of Economic Research concluded that, once the housing characteristics and asking prices are factored out, brokers actually "reduce the selling price of the typical home by 5.9% to 7.7%... which indicates that agency costs exceed the advantages of brokers' knowledge and expertise by a wide margin."

Since then, consumers' purchasing habits and preferences have radically shifted. One major change: the acceptance of peer-to-peer transaction platforms, such as Airbnb, HomeAway, Uber, Etsy and eBay. This undermines the traditional agents' argument that their unbiased guidance created a buffer of objectivity that would result in better negotiation and a more satisfying sale result.

Investors and consumers are losing patience with the high cost of the cozy culture of

Overdue for a Commission Revolution

*Real estate commissions in the U.S. are out of line with international norms.**

Resistance to the 6 percent norm has been predicted for years. In 2002, an article in the International Real Estate Review predicted the early success of online 'for sale by owner' websites would spark the collapse of the traditional structure. "If the typical US agent were as productive as those in England, the brokerage fees would be closer to 1.5%," according to the article's authors.

Of course, the real estate bubble insulated traditional brokers from commission pressure; homeowners were fixated on the top line, not on the bottom line. Private equity put a floor under the residential market when the bubble burst in 2007. Now, as home values recover in a slow-growth, low-interest-rate economy, those investors are examining all aspects of the transaction process with an eye to squeezing out cost and teasing out efficiencies.

**See sources below.*

traditional brokers. A 2015 study by the National Bureau of Economic Research found that listing agents and buyers' agents have a culture "consistent with real estate agents steering buyers to properties with high commissions." For properties listed with alternative brokers, this subtle but pervasive dynamic can result in properties staying on the market 12% longer.

Takeaways and Conclusion

Institutional investors and portfolio managers can assess the impact of transaction costs on their net return by:

- Analyzing the internal cost of managing multiple brokers across the country
- Requiring 'success rate' data from brokers, benchmarking each broker's average time on market and total sell-side transaction cost compared to the aggregate success data from that region's multiple listing service. For example, in September 2016, USRealty.com had a success rate of 80.65% for customers offering the traditional 3% buyer's side commission, compared to 81.59% for all MLS listings, which tend to offer 3% buyer's side commission.
- Breaking out the discrete costs of selling on an 'a la carte' basis compared to the bundled cost offered by local brokers. Costs might include: MLS listing fees, property showing, staging, property maintenance, and closing fees.
- Conducting a pilot in a large market by listing properties with both a low-fee broker and with a traditional local agency, analyzing fees, results and net return for both.
- Institutional investors have created the critical mass required for a 'commission reset'

How CastleRock Realty Group Maximizes Return Managing & Selling over 2,500 Houses Annually

Every single-family property is unique. That's both the opportunity and the challenge for CastleRock Realty Group, based in Westchester, NY.

In 2016, CastleRock REO is on track to buy, manage and sell over 2,500 single-family houses, mainly foreclosed properties from banks and mortgage lenders. That's up from 2,000 properties in 2015, and the company expects 3,000 of those properties to flow through its portfolio in 2017.

Negotiating smart purchase and sale prices, as well as its longstanding reputation with the major national banks, are key reasons why CastleRock REO has grown steadily, despite a decline in nationwide REO holdings. The company's investors enable it to purchase up to $100 million a year in distressed real estate, says president and co-founder Jason Epstein. Streamlined selling processes, including the swift and simple channel of listing houses on the multiple listing service through USRealty.com, are a major supporting factor to overall return.

Before starting to work with USRealty.com in 2011, CastleRock REO relied on local do-it-yourself marketing to sell houses: yard signs, local ads and, occasionally, listing with local, full-service, full-commission real estate agents. Now, though, only unique properties or unusual circumstances warrant the high-cost, high-touch approach of a full-service agent, according to Epstein. "You might need a local broker on a property that's harder to sell but if you have properties that you price right and the market is good, you should be able to use USRealty.com effectively and maintain the traffic you need to sell the property," he says.

CastleRock REO offers buyers' agents the standard, traditional commission and asks them to handle routine tasks such as showing the properties. About 70% of CastleRock REO properties are sold to owner-occupants and 30% to local investors.

Saving both money and time is essential when managing volume sales.

CastleRock REO's 20 staff asset managers oversee selling and transaction operations, and through USRealty.com, they can directly control buyer inquiries, negotiations, communications and other details, thus minimizing confusion. "Every dollar we save helps with the bottom line," says Epstein. "If we can save $1,500 to $3,000 per home, that adds up."

for the entire residential real estate market. In the past, brokers have been insulated from change forces due to the fragmented market and the nature of working a constant turnover in clients, as individual homeowners tend to sell houses every few years. But investors who bring a steady stream of houses to market in multiple regions have the power to shift the industry norm by listing with low-cost, highly effective brokers that deliver returns that investors demand.

About USRealty.com

USRealty.com is a national real estate brokerage that enables property owners to list their properties with local multiple listing services, and thus with the most popular online listing sites, from a single point and with full transaction, reporting and administrative support.

2.84%

Average commission paid by USRealty.com customers, compared to 5.1% for the U.S. average for single-family properties.

Sellers choose the commission they want to pay for a successful sale.

Sellers choose which selling support services they need and pay only for those services.

Success Metrics

8,160

single-family houses sold in 2015

64% to 80%

Success rate for USRealty.com listings, depending on the buyer's agent commission offered by the seller

$2.2 billion

Aggregate value of properties sold

How It Works

Through its Pennsylvania call center, USRealty.com, a national broker, lists properties through its memberships in 110 multiple listing services and proprietary network of cooperating agents and brokers. Listings flow quickly to major online listing sites, where home buyers look for, and find, properties.

USRealty.com customers pay a flat fee to initiate each listing plus a negotiated success fee at each closing. Sales completed through multiple listing services are required to pay co-operating brokers the contracted commission, typically 2% to 3%.

This ‘a la carte’ model enables sellers to control expenses and selling costs by deciding what services they need. More control over selling costs translates to more opportunities to capture greater return through a cost-efficient, streamlined selling process.

USRealty.com Services

For property investors and portfolio managers, USRealty.com offers:

- A streamlined, single point of contact for listing properties in all locations.
- Tools, reports, and measurements for assessing key metrics and transaction costs to evaluate and track selling expenses and net return.
- Dedicated customer support through the Pennsylvania support center.

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