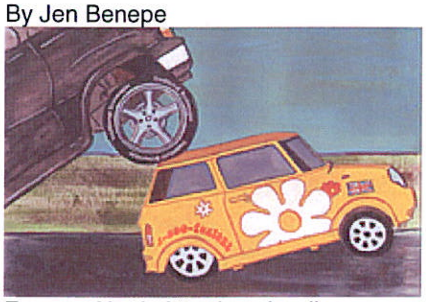
THE REAL DEAL

November 2007

Behind discounter Foxtons' demise

Brokers bid a tearless farewell to discount brokerage upstart

By Jen Benepe



Foxtons North America, the discount real estate brokerage that caused a splash when it came to the U.S. more than four years ago, filed for Chapter 11 in the United States Bankruptcy Court for the District of New Jersey last month.

The move marks the end of the firm's attempted incursion in the tri-state area, complete with brand-splattered Mini-Coopers, tidy green-and-yellow house signs, British accents and frothy cappuccinos served to clients.

Experts say the bankruptcy workout process could take months, not days, leaving more than 2,000 New York City sellers in limbo as the selling season goes into winter hibernation.

In limbo too, at least for the time being, will be the concept of a low commission, low-service firm, an idea that met resistance from other brokers in the New York region.

U.K. roots

It may come as a surprise that Foxtons North America's ancestor, the British version, is actually a high-end brand.

"Most people don't realize that Foxtons are the premier prestigious company in London, and everyone wants to be listed with Foxtons or have them represent them when they are renting properties," said Heather Bise, a broker for DJK Residential who represents many international clients in the U.S.

Not only is Foxtons U.K. a high-service firm, it's also a high-commission firm: In the U.K., standard commissions average 1.5 percent, but Foxtons would charge 2.5 to 3 percent.

To justify that billing, the firm makes a swashbuckling promise: 10 percent greater sales price on your home if you list with them.

"They say they are going to get you more, and they get you more," said Bise.

Company founder Jon Hunt certainly got more, selling the London-based operation to BC Partners Ltd. for £390 million -- about $800 million -- in May.

Unfortunately for Hunt, he kept Foxtons North America as a separate company as part of the transaction.

Hunt had not made himself available to the media as of press time.

U.S. history

Foxtons had made a bold entry in the U.S. market in 2000, buying out brokerage firm Your Home Direct Realty (later shortened to YHD Realty), a discount commission realty started by Glenn Cohen.

"They scared the entire brokerage community out of their wits; people were thinking this was Doomsday," said Fernanda Forman, managing director of Bond Property Marketing Group. "The same reaction was all over -- 'How can we compete with these guys?'" Forman said.

But the company failed to get much traction. After struggling with the discount model in New Jersey and especially in New York, the company recruited 49-year-old Van Davis, previously chief executive officer of full-service brokerage Century 21, as its new CEO.

Davis adjusted the firm's strategy by bringing the discounted commission up from 2 percent to 3 percent -- then later, according to reports, to 4 percent (compared to the standard 6 percent commission seen at traditional brokerages).

Still, the low "co-brokes" paid to cooperating brokers -- either buyer brokers who showed their clients Foxtons' listings, or seller brokers, who showed their properties to Foxtons' clients -- may have been the crucial factor that worked against the Foxtons' discount model.

"In New York City, the seller pays, and if there is only 2 percent, there is not enough money to split the deal," said Janice Silver, executive vice president and sales manager of Bellmarc Realty, East Side.

Even 4 percent may have been too little, too late to compete in the tri-state area, one of the most complicated real estate markets in the world.

"I don't think people are looking for discount brokers. I think they are looking for effective brokers, someone who could sell their home," said Lynn Epstein, president of brokerage Devlin-McNiff, which operates in Suffolk County.

Dottie Herman, president and CEO of Prudential Douglas Elliman, said that when Foxtons first came to Long Island five or six years ago, "they had no offices. They had cheap commissions, but basically, they did not do anything."

Herman, whose company has about a 20 percent market share on the Island, said she doesn't think it was the discount model that made the company fail, but their business model. "There are a million discount brokers, and there will always be discount brokers. That wasn't the problem," she noted.

Despite very good advertising and marketing, Herman said it appeared as if the salespeople did not know the market well and just put a listing on the Internet.

Because the firm only offered minimal marketing and very little support, Herman said, "I used to tell clients, if you're going to pay them just 2 percent, you're better off just doing it on your own instead."

Low-service marketing plan

Foxtons' model was to have the seller execute the bulk of the marketing of the home themselves, placing the ads, showing their property, and working with buyers and buyers' brokers. The company, for its part, would list their property on the Foxtons' Web site, provide a sign for the front yard, and come into the picture once the property received offers to assist with contracts and closing.

The company spent a great deal of money on mass marketing. "They had a big billboard over the tunnel entrance coming back from East Hampton," recounted Silver. "My husband would say, 'Oh, Foxtons is taking over,' and I would say, 'They are not taking over anything.'"

The company also had a free marketing publication that was available at newsstands every month, large targeted mailing lists, and half- or full-page newspaper ads showing their listings.

Though the company claimed on its Web site to have "over 200 new homes for sale each week," the firm did not have much of a presence in New York City. In New Jersey and New York, near the end of October, it had no homes listed for sale on its Web site in Manhattan, 163 in Staten Island, 231 in the Bronx, 748 in Brooklyn, and 1,313 in Queens. In total, the firm had only 2,834 listings on its Web site in New York State, including New York City and Long Island.

Foxtons' New Jersey presence, by contrast, was much greater, with 44,555 homes listed for sale on its Web site, including commercial and residential properties, rentals and raw land. It's not clear how many of those properties were exclusive listings.

Many brokers claim never to have seen the firm's listings. "The only place I have seen any of Foxtons listings was when they were placing full-page ads in the New York Times," said Forman.

Devlin-McNiff's Epstein said what hurt Foxtons the most was that they never had local offices, "just signs and a phone number." In a market like the Hamptons, "where 80 percent of the business is done by 20 percent of the brokers," she said, "you can't drop in from outer space and do well."

Aside from not integrating themselves with the brokerage community, Foxtons may have simply not been prepared for the complex details necessary to pull off deals in the New York City market. Silver said about 80 percent of Bellmarc's business is in co-op sales, an area that is far too complex for a virtual office agent to handle.

A lot of work needs to be done by the broker for co-op sales, she explained. "They recommend a mortgage broker, or a banker, an attorney, they know the managing agents of the buildings, and we also instruct people how to present themselves to the board for approval," Silver noted. "Can you imagine a virtual agent filling out a board package that often goes 200 pages?" she asked.

Sellers in limbo

Now, a message posted to Foxtons customers on the Foxtons.com Web site reads, "We regret to inform you that, due to the recent down turn [sic] in the residential real estate market, Foxtons has decided to conduct an orderly liquidation of its business."

The note, signed by Mark Horvat -- the company's vice president of sales -- also says that the company will be filing for Chapter 11 bankruptcy and will seek to have active listings "assigned to another real estate broker."

As *The Real Deal* went to press, Brooklyn-based Fillmore Real Estate won the bidding for Foxtons' sale of 1,400 home listings in the New York area for $110,000. Fillmore said it also took on 15 former Foxtons agents with plans to hire more. In New Jersey, Foxtons agreed to sell its listings to a joint venture of Century 21 Atlantic Realty and Maplewood Homebuilders.

Repeated calls to the Foxtons headquarters, as well as to their subsidiaries, including mortgage company Foxtons Financial and Safeguard Title Agency, were not returned.

The company listed $40.9 million in total liabilities and $488,000 in assets in a bankruptcy court filing, according to news reports.

In 2006 Foxtons, showed $32.3 million in sales, according to financial research company Hoover's.

Past troubles

Foxtons North America and its subsidiaries had been sued in a class-action suit in the United States District Court for the District of New Jersey in 2004. The plaintiffs alleged that Foxtons, acting as their broker, charged fees and received a yield spread premium without disclosing the information to them until the time of closing.

The class-action suit included anyone who had "purchased, or sought to purchase, a home listed for sale by Foxtons and who have paid a prequalification application fee, or who have received and accepted an offer from Foxtons for a fixed interest rate mortgage loan that Foxtons failed to deliver as promised and who have suffered damages as a result," according to court documents.

The complaint was settled out of court for an undisclosed sum in October 2005.

Also, in 2004 and 2006, the Foxtons North American mortgage brokerage, Foxtons Financial, was investigated by the New Jersey Department of Banking and Insurance for allegedly using unregistered solicitors and failing to disclose mortgage application fees to borrowers. The company was found to be guilty of two administrative violations, was fined separately $50,000 and $100,000, and paid the violations, said Jim Gardner, communications manager for the agency. In late October 2007 the company also paid a $12,000 fine for technical violations in issuing loan commitments, said Gardner.

Many saw the fact that Hunt, the former Army officer who founded Foxtons, stayed with the company as a stamp that the Northeastern U.S. market was as strong as ever. Foxtons North America did not pay its salaried workers lavishly, however. They earned about $25,000 to $35,000, plus a $500 bonus for every property sold.

There was no increase in commission if the sale was for a greater amount, or more complex, according to brokers. "They can't live out here on that," said Epstein, referring to her Hamptons location.

As far as co-broking for paltry splits, Steven Spinola, president of the Real Estate Board of New York, noted that it would be the fiduciary responsibility of a broker to show their client a Foxtons property if they were interested. (Based on numerous comments splattered across the Web, and indications from brokers *The Real Deal* spoke to, few brokers are interested.) However, Herman said her brokers did work on Foxtons deals if they were listed on the Long Island MLS: "We co-broke everything."

Spinola said he had no record of Foxtons applying for membership in REBNY, and he did not see any reason why their application would have been rejected. He also said their commission structure would have had no bearing on the membership decision. "Commissions are negotiable in every deal," he noted.

Nationwide, realtor commissions paid on U.S. sales of residential real estate will total an estimated $51 billion in 2007, down from $59.44 billion in 2006, said Steve Murray, editor of Real Trends, a residential research and analysis firm.

While 6 percent is the ostensible industry standard when it comes to commissions for traditional brokerages, the average commission paid in 2006 was actually closer to 5 percent, a Real Trends report found.
