Consumer Federation of America

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CHANGES IN REAL ESTATE AGENT REPRESENTATION: IMPLICATIONS FOR CONSUMERS

Report prepared by Stephen Brobeck, Executive Director, Consumer Federation of America, October, 1994

How real estate agents represent consumers is changing rapidly and growing more complex. This report describes these changes in real estate agency and advises home sellers and buyers how they should respond, including negotiating lower commissions. It also outlines the role that state real estate agencies should play to ensure that consumers are well-informed about changes in agency.

Changes in Real Estate Agency

Despite accelerating changes in real estate agency, subagency remains the most frequently used type of agency. Although subagency serves sellers fairly well, it discriminates against buyers. Those working with subagents usually are not adequately represented in negotiations over price. To make matters worse, at least until recently most buyers thought that they were being represented. As a consequence, they not only relied on subagents to work out a deal, but often communicated potentially compromising information that subagents were legally obligated to pass on to listing brokers. The result was that buyers frequently overpaid for homes, 5 percent according to one survey. And if they later learned that this was the case, they sometimes sued the subagent. One response of these agents was to act more like facilitators, or even buyer brokers, but this exposed these agents and their listing brokers to lawsuits from sellers.

A combination of this litigation, challenges from exclusive buyer brokers, criticism from consumer groups, and related press coverage have eroded the dominance of the subagency system. Traditional brokers have begun to experiment with alternatives to subagency that stop short of complete separation of listing and buyer brokerage. It is their hope that they can develop a new type or types of agency that minimize the problems with subagency, yet allow them a continuing opportunity to capture the entire commission. There are basically three kinds of alternatives being tried.

In the first, brokers represent neither buyers nor sellers. For the most part, this is true of both facilitatorship and transactional brokerage. Here, brokers seek only to facilitate the sale. The advantage to them is that they retain the possibility of being the only broker, thus receiving the entire commission, while limiting their liability. But they face two problems: Consumers may want more than a facilitator. They may wish to work with someone who represents their interests and can be held accountable.

The second problem is that limiting the role of brokers also ought to limit their compensation. But if there is one goal that is shared by nearly the entire industry, it is the preservation of existing commission levels. After all, a reduction of commissions by only one and one-quarter percentage points would lower broker income by about $5 billion annually. But according to at least one report from Colorado, transactional brokerage is lowering commission levels. From a consumer perspective, if compensation is reduced, facilitatorship can be one attractive option.

The second alternative to subagency is dual agency. This represents an effort by brokers in some states to have one's cake and eat it too. Dual agents seek to limit liability by declaring that, in a transaction, they represent both the buyer and the seller. Moreover, since they are representing, not just facilitating, they believe that they can preserve existing commission levels.

The problem with dual agency is that, fundamentally, it does not make any sense. How can a broker adequately represent the interests of both buyers and sellers? True, new mandatory seller disclosures about the condition of the property make dual representation easier. But there is still the dilemma of establishing a sale price. Clearly the broker cannot represent both buyer and seller interests in this determination. The result is that dual agents are forced to act more like facilitators than agents. Yet this is deceptive. If brokers only facilitate, then they should acknowledge that and not try to mislead consumers. They should also be paid less.

The third and most promising alternative to subagency that is being tried by traditional brokers is nonexclusive buyer brokerage. This is especially attractive to large firms in markets with fairly sophisticated customers. Buyers who understand the disadvantages of subagency and the limits of facilitatorship, are increasingly demanding buyer brokerage. But most of these buyers turn for buyer brokerage services, not to exclusive buyer brokers, but to large firms. These firms typically assign a buyer broker to the buyer who then has an obligation to represent their interest. And if the agent does not do so adequately, there is liability that can serve as the basis for a lawsuit. In some areas, nonexclusive buyer brokerage has grown rapidly. In the Washington, D.C. area, according to one report, well over half of the buyers working with large firms are represented by buyer brokers.

Despite this increased popularity, this type of buyer brokerage still faces a dual agency dilemma. Its most severe form involves buyer brokers who also have listed properties. To whom do these brokers owe their allegiance -- the sellers whose properties they have listed or the buyers whom they are representing? Specifically, should they push their listed properties on their buyer clients? Is they do so, they usually are not objectively searching the market for the best properties for buyers. But if they do not, are not they betraying their seller clients? In practice, these nonexclusive buyer brokers often try to split the difference. They show but do not push some of their listings to buyers. Yet, still they are not adequately representing either buyer or seller clients.

The other dual agency problem facing nonexclusive buyer brokers, and even exclusive buyer brokers in firms that also list, involves the listings of their firms. If the firm is large, buyers may be presented with a fair sampling of the entire market. Also, since the buyer broker must split the commission, there is less financial incentive to promote those properties than their own listings. Still, these buyer brokers are encouraged, and often pressured, to push the firm's listings. Since firms rarely list over half of all properties in a market, they are unlikely to carry the best one for the buyer, so are providing inadequate representation.

These dual agency problems are why it is desirable to separate completely listing and buyer brokerage. Listing brokers should work only for, and receive compensation only from sellers, and buyer brokers should represent buyers exclusively and be compensated by them. The fact that both parties would be able to negotiate compensation would tend to reduce total commissions paid.

At present, however, there is too much institutional resistance to, and insufficient political support for, requiring separation of listing and buyer brokerage. Given this reality, it is desirable for firms to designate certain agents as exclusive buyer brokers, then for these buyer brokers to disclose any listings of the firm that they show and acknowledge the firm's financial interest in these listings. This practice would significantly lessen dual agency problems.

<u>Advice to Consumers</u>

<u>To Sellers</u>: CFA recommends that sellers ask agents whether these agents will represent them exclusively. If the answer is no,

they should request a substantially reduced commission level. In either case, however, sellers should ask agents to agree to a reduced commission if the agent ends up not having to share the commission with another agent. This will occur if the agent finds the buyer or if the agent works with a fee-based buyer broker.

The willingness of agents to agree to lower fees will vary from area to area and from agent to agent. But in an area where agents typically advertise a 6% commission:

> If the agent represents only you and shares the commission with another agent, pay 5-6%.
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> If the agent does not exclusively represent you and shares the commission with another agent, pay 4-4.5%.
>
> If the agent represents only you and does not share the commission, pay 3-4%.
>
> If the agent does not represent you and does not share the commission, pay 2.5-3%.

<u>To Buyers</u>: If you want representation, work with a buyer broker. They are legally obligated to represent your interests in any negotiations with sellers. Even though most buyer brokers split the commission of listing brokers, so that they have at least some financial incentive to keep the sale price high, in most cases they will honor their fiduciary responsibility to you. In the long run, the referrals and repeat business generated by a good reputation are most important. Moreover, if the buyer brokers do not honor their duties, you can sue them.

Because buyer brokers who also list properties may face conflicts of interest, it is better to work with a buyer broker who represents only buyers. But if you work with a buyer broker who also lists, or who works for a firm that lists, insist that the agent disclose any of these listings that they present to you and indicate their financial interest in these listings. You may also want to avoid disclosing any confidential financial information until you know that none of the listings of the firm are of any interest to you.

If you work with a nonagent -- a dual agent, facilitator, or transactional broker -- make certain that you thoroughly investigate the condition of the property yourself with the assistance of a home inspector, and also make sure that you negotiate the price yourself or hire an attorney to do so.

If you end up working with the seller's agent, and this agent is the only one involved in the transaction, do not disclose any information about what you are prepared to pay, negotiate price yourself or hire an attorney to do so, and counteroffer with a significantly reduced sale price. Since the agent does not have to split the commission with another agent, he/she may well be willing to reduce the commission significantly, thus allowing the seller to lower the sale price without reducing the compensation they receive (i.e., the sale price minus the commission).

Do not work with subagents unless there are no other alternatives. In a home sale, it makes no sense for there to be two agents representing the seller. You will not receive representation in the transaction and are likely to pay top dollar.

The Role of State Regulators

State regulators have an essential role to play in protecting the consumer in this agency transition. First and foremost, they should inform buyers and sellers about their state's agency system or systems and their implications for consumers. Where once there was only widespread ignorance, now there is confusion as well reflecting the complexity of real estate brokerage, its changing character, and the use of imprecise or ambiguous language by real estate practitioners.

State agencies should take the lead in informing buyers and sellers about the choices available to them and the financial implications of each. This education should begin with a required written disclosure at the first substantive contact between broker and client. It should continue with the aggressive distribution of information materials that brokers could be required to give clients along with the disclosure. (The CFA/AARP pamphlet is one model for such materials.) And it should include energetic dissemination of information to the press.

A second role for regulators on agency is to see that there is truth in labeling. Brokers should be required to accurately and understandably label the practices that they advertise. For example, they should probably require transactional brokers to call themselves facilitators. More important, they should not permit the self-contradictory term, "dual agent," to be used.

Finally, it is important for regulators to encourage the industry to employ pro-consumer practices. Particularly now that the industry is in a period of transition and some confusion, regulators have the opportunity to take the lead in working out a solution to the agency problem. It might even be useful for these regulators, like insurance regulators, to develop model standards that states could adopt.