A Reprint from *Tierra Grande*

Spotlight on Agency

By Jack C. Harris

The annual meeting of the American Real Estate Society is an opportunity to explore research findings in the field of real estate brokerage. The 2003 conference in Monterey, California, held insights into the extent to which money motivates real estate professionals, and problems related to dual agency.

Not Always About the Money

Economic analysis usually is based on the assumption that individuals interacting in a market do so to maximize their welfare. In other words, they are expected to make decisions that promise the highest monetary return.

However, human beings often select alternatives based on personal values rather than income. They may choose a more pleasurable course, for example, or one less fraught with risk. In a profession in which the primary incentive is monetary gain, these values complicate decision-making for managers and clients alike. To better understand how, several researchers looked at agent compensation and how it affects agent behavior.

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Dual Agency Issues Not Easily Solved

No one expects to walk into a store and get candid opinions about merchandise quality from the store's salespeople. Yet homebuyers often rely on the advice of a real estate agent employed to represent the seller.

Most agents do not act as buyer agents, exclusively. When an agent is contracted to represent a buyer and that buyer expresses interest in a property listed by the agent's firm, a potential conflict of interest is set up. An agent who brokers a transaction of this type is guilty of dual agency — swearing loyalty to both sides in the negotiation.

The industry has developed ways to mitigate the problems of dual agency. The agent may disclose the situation,

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One of the basic decisions agents make regarding income and incentives is the method by which they are compensated. Individual agents may receive the entire commission from a sale and nothing more, or some portion of the commission with supplemental salary.

Companies that exclusively use the all-commission structure promote the idea that they have the most skilled agents and, therefore, are more effective in selling their clients' properties. This implies that housing markets are somewhat inefficient because an efficient market would not produce a price premium simply for a strong marketing effort (although it could be argued that a less-skilled agent might fail to get the full market value for a property).

Leonard Zumpano (University of Alabama), Randy Anderson (City University of New York) and Ken Johnson (Auburn University Montgomery) used statistical methods to study how agent characteristics determine what type of compensation package they choose. They applied a statistical model to explain the probability that an agent would have a 100 percent commission arrangement as opposed to a split-commission agreement with the broker-owner. Data on agents come from the 2001 Membership Survey of the National Association of Realtors®.

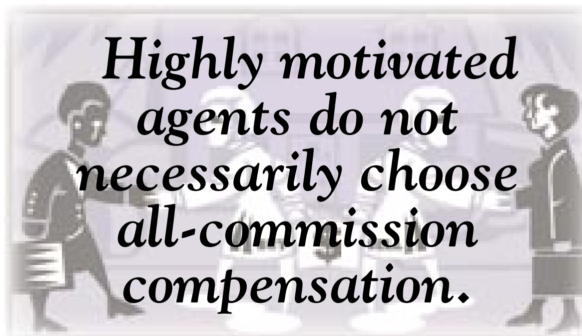
As expected, the more productive the agent, the more likely he or she was to have an all-commission package. Those with higher income from all sources were more likely to be all-commission agents. High income tends to soften the risk inherent in a strictly commission arrangement.

Job satisfaction, as measured by how long the agent had worked for the same firm, tended to correlate with the more traditional commission-salary split. In other words, agents who felt comfortable going for maximum income chose all-commission, while those who placed more value on a pleasant work environment chose the split plan.

Number of hours worked was not an important determinant of compensation choice. The authors interpreted this as indicating that highly motivated agents do not necessarily choose all-commission compensation. Consequently, offering a larger commission split may not elicit greater effort and production.

All-commission agents tended to earn more while working fewer hours. This could be the result of greater specialization in an area or property type or in handling one side of the transaction.

If income is not the overriding concern when negotiating with their firms, will agents respond to direct incentives, such as a bonus for selling a particular home?



According to research conducted by Ken Johnson, Randy Anderson and Justin Benefield (University of Alabama), the answer is no.

A seller offering a bonus commission expects to sell the home for more than market value, thus recouping the bonus, or shorten the time the house is on the market. But researchers' analysis of sales in Montgomery, Alabama, during 1998 indicates that homes sold under a bonus commission actually sold for less than market value and required more marketing time than homes sold without the bonus.

With all market-value-related factors accounted for, properties listed with a bonus to the selling agent sold for a discount of 3.6 percent to the market. A separate analysis of the same data shows that homes listed with a sales bonus required an average of 35 additional days to sell.

Such counterintuitive results make more sense in light of market pricing theory. Sellers can adopt one of two strategies. A "pricing" strategy requires the property to be put on the market with a below-market price to attract buyers and minimize time on the market. Alternatively, a seller may adopt an "exposure" strategy by overpricing the property and using more aggressive sales methods, such as offering a bonus to the agent who provides a buyer willing to pay the target price.

A pricing-strategy seller might not need to list the property for less than market value, but might be more accommodating in negotiations. On the other hand, the exposure-strategy seller depends on buyers being relatively uninformed regarding market prices and thereby susceptible to a more aggressive sales effort. The finding that such a strategy actually resulted in lower prices indicates that most buyers were aware of what the home was worth and were ignoring the listing or submitting much lower offers. This may also indicate that agents felt that they could not persuade buyers to pay above-market prices despite the additional incentive of the bonus.

The finding that bonus sales required more time to sell is consistent with exposure-pricing strategy theory. By attempting to get above-market price, the seller necessarily accepts the prospect of a longer marketing time. The demand for such listings is diminished by the loss of those buyers who recognize it as overpriced. The seller is left with buyers with little market knowledge or buyers uniquely attracted to the specific property.

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so as to put both seller and buyer on guard against revealing any compromising information (although they already may have revealed some such information). The agent may find another agent within the firm to take over representation of the buyer. Or the agent may complete the transaction as a neutral intermediary.

Do any of these maneuvers really nullify the problems of dual agency? Based on evaluation of these techniques, Professor Bruce Lindeman (University of Arkansas at Little Rock) does not think so.

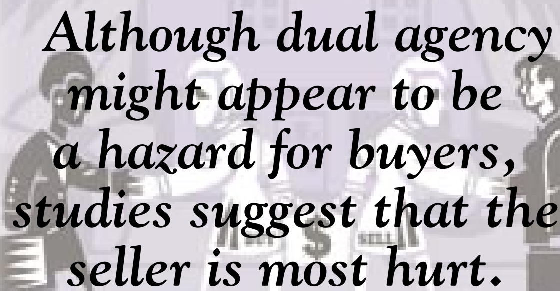
Disclosed dual agency. In theory, disclosure should prevent both the buyer and seller from divulging information to the agent that they would not want to share with the other party. However, according to Lindeman, this arrangement renders the agent unable to fulfill the fiduciary duties required to be an effective agent. The agent cannot advise either side for fear of harming the negotiating position of the opposing side.

Designated agency. In this case, the buyer agent picks another agent to represent the buyer for that transaction only. Lindeman points out that the listing agent already may have confidential information about the buyer gained during their previous relationship. Can the agent somehow "forget" this information during subsequent negotiations? Although this arrangement is the most widely used, it is little improvement over disclosed dual agency.

Transaction brokerage. Here, the agent handles the transaction without representing either side. This is no different from dual agency with disclosure. Each side gives up its right to representation.

Dual agency may be potentially harmful, but is there any evidence of actual damage to either party? Richard Evans and Phillip Kolbe (University of Memphis) used a repeat-sale price index to measure the impact of various agency relationships on sales prices. A repeat-sale price index measures the trend in property values over time. If a lot of sales data are available, it is one of the best ways to get a true indicator of appreciation.

The analysis was applied to multiple listing sales for an unidentified metropolitan area from 1997 through early 2003. The authors identified sales for which the same agent was used by both buyer and seller (dual agency) as well as sales in which the buyer used the same agent to sell the home at a later date. If the buyers and subsequent sellers of the homes paid market prices, the homes' appreciation should have matched the overall market. Any disadvantageous (or favorable) effects would have resulted in a lower (or higher) rate of appreciation.



Evans and Kolbe found that homes bought under dual agency or sold without exclusive representation achieve lower price gains than the market trend. They interpret this to mean that these buyers paid too much for the homes, sold for too little or both.

Buyers who use the same selling agent to later sell the house experience higher gains. The authors speculate that buyers tend to return to an agent who got them a good deal when they purchased. Also, agents who are familiar with the home may be better able to sell it later.

Support for these conclusions exists in a recently published study by Joachim Zietz of Middle Tennessee State University and Bobby Newsome of Mountain Heritage Mortgage, Inc.

Sales data from the Orem-Provo, Utah, region compiled during 1999 and 2000, were used in a statistical model to isolate how the type of agency representation affected sales price. The effect, they found, was not significant for very small or large properties. But buyers of small- to medium-sized properties not using a buyer representative paid a slightly higher price (around 2 percent). The authors point out that buyers in this market segment tend to be first-time, inexperienced buyers who benefit significantly by having a buyer representative.

Buyers paid 3.7 percent less when the buyer's representative and the seller's representative come from the same firm. Although dual agency might appear to be a hazard for buyers, this study and the one by Evans and Kolbe suggest that the seller is most hurt.

These studies show that markets are more complicated than expected. What seems obvious often is not borne out by actual results. However, there usually is a plausible explanation for the anomalies.

Dr. Harris (jharris@cgsb.tamu.edu) is a research economist with the Real Estate Center at Texas A&M University.

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Tierra Grande (ISSN 1070-0234), formerly *Real Estate Center Journal*, is published quarterly by the Real Estate Center at Texas A&M University, College Station, Texas 77843-2115. Subscriptions are free to Texas real estate licensees. Other subscribers, $20 per year.

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