

INTRODUCTION

THE REAL ESTATE BROKERAGE INVESTIGATION AND REPORT

The Los Angeles Regional Office of the Federal Trade Commission, working in conjunction with the Seattle Regional Office and the FTC's Bureau of Economics, conducted a nationwide investigation of the residential real estate brokerage industry from 1978 through 1981^{1/}. This investigation was coordinated with the FTC's Bureaus of Competition and Consumer Protection and was conducted throughout under their general sponsorship.^{2/} This Report reflects the results of that investigation. Its purpose is to explain how competition works in this industry and how the consumer is served in the real estate brokerage process.

The investigation into the real estate brokerage industry was initiated in response to the following facts:

- The FTC had received complaints from sources within the brokerage industry claiming harassment and boycotting of brokers who charge lower than "customary" commission rates or who offer services that differed from those which were "prevalent."
- Other brokers had criticized to the FTC various practices of such institutions in the industry as local multiple listing services (which are real estate brokerage exchanges), trade associations, or state real estate regulatory agencies.
- Complaints to the FTC as well as public statements of consumers and consumer groups called the attention of the FTC staff to public concern over the high degree of uniformity perceived in commission rates in any given local market and over a perception that consumers were kept ignorant of "key facts" felt to be necessary for informed decisions in choosing a broker or in selling or buying a home.
- Antitrust suits, articles, and studies in legal publications and the economic literature all contained allegations suggesting problems in the competitive process in this industry.

Several decisions were made as to the scope to be given to the investigation. We determined initially that we would focus on brokerage practices relating to residential sales as opposed to practices that might be associated with commercial real estate sales, sales of raw land, investment counseling, property management, or any of the other professional activities

^{1/} File Nos. 762 3052, Unnamed Real Estate Brokers and Others, and DC P184-010, Real Estate Brokerage Industry.

^{2/} Responsibility for this Project was transferred by the Bureaus of Competition and Consumer Protection to the Los Angeles Regional Office on February 17, 1978. See "FTC Los Angeles Regional Office to Coordinate Real Estate Brokers Investigation," FTC news release (March 31, 1978).

frequently engaged in by real estate brokers.^{3/} We also focused the investigation on structures and patterns of practices that seem widespread, as opposed to studying individual, anecdotal problems. We identified five areas for principal emphasis: (1) the nature and role of the industry's trade associations; (2) the nature and role of state law and the state agencies that regulate the brokerage business; (3) the structure and operations of multiple listing service brokerage exchanges (MLSs); (4) the problems faced by "alternative brokers" — those brokers who offer commission rates or services which differ significantly from the norm of those available in their local market; and (5) the nature of the broker/consumer relationship, including issues of potential conflicts of interest between broker and client and the adequacy of the protection given to the interests of both buyers and sellers.

A description of the methodology of the investigation is set out as Appendix A to this Report.

The Investigational Staff Report

The investigation conducted by the Los Angeles Regional Office supports the widespread belief that the industry is characterized at the local level by structures and practices which are common to essentially all of the nation's geographic brokerage markets. The Report summarizes the findings of the investigation and is focused on the five principal areas of study listed above. In addition, we attempt to analyze the effects both of how real estate firms do business with each other and the prior history of industry efforts to stabilize fees and commission rates.

In the course of analyzing industry structures and practices, it became apparent that individual competitors in this industry depend on one another to an extraordinary degree in order to sell homes efficiently. The real estate brokerage industry in any given market operates largely as a single interdependent system for selling homes. The consequences of that high level of interdependence are a predominant theme of the Report. We believe that this interdependence tends to generate, reinforce, and exacerbate two broad performance problems as side effects to the benefits which cooperation confers on consumers. A lack of price competition is, of course, unusual in a market with numerous firms, low barriers to entry, few start-up costs, only very limited government regulation of the terms of dealing, and wide variations in both the prices of the numerous unique properties brokered and in the selling abilities of individual salespersons. Interdependence in this industry may, however, encourage a lack of price competition. When coupled to a system under which most brokers and salespersons are not on salary but instead depend upon their own commission earnings, it may lead to the low level of productivity (low dollar sales output per hour worked) which has been attributed to this industry by many observers. It may also provide the mechanism for a widespread, even if informal, withholding of cooperation from "mavericks" who bid for market share in "unusual" ways, in an industry where a high level of cooperation usually is necessary to do business effectively.

The cooperative nature of the industry also appears to result in less than optimal information about the brokerage process being given to consumers.

We have divided our Report into the following four chapters:

Chapter I: Summary, briefly outlines the three succeeding chapters and

^{3/} The National Association of Realtors had determined that "85% of NAR members are in residential real estate." NAR

intended to provide an "executive overview" for readers and a short statement of conclusions for those who do not choose to read the entire Report.

Chapter II: Real Estate Brokerage: An Analytical Framework, provides the reader with the concepts needed to analyze the brokerage industry. This chapter describes the functions of a broker in general terms, notes the unique aspects of real estate brokerage and its unique problems, and outlines the nature of the interdependent relationship among brokers.

Chapter III: Industry Performance, is a descriptive chapter that presents empirical information on the performance of the industry, first in terms of prices, costs, and resource utilization, and then in terms of the information and services which brokers provide to consumers.

Chapter IV: Analysis of Industry Structures and Practices, builds on the two preceding chapters and examines how the basic industry structures and practices lead to certain widespread dysfunctions in industry performance. The chapter examines in turn the roles of: trade associations, state regulatory laws and agencies, multiple listing services, "standard" brokerage firms, "alternative" brokers, broker/consumer relationships, and the lingering effects of a prior history of price fixing and fee stabilization.

A Conclusion briefly ends the body of the Report. The Report is followed by several Appendices discussing the methodology of the investigation and exploring particular factual topics in more substantial depth.

GLOSSARY OF TERMS

Alternative broker: A broker who advertises or otherwise publicly offers commission rates (fees) or services significantly different from the prevailing rates or services in the community. To be significantly different for purposes of this report, a rate must be two percentage points below the prevailing rate. The terms "discount broker" and "flat-fee broker" refer to types of alternative brokers.

Board of Realtors (often "Board"): The local affiliate of the National Association of Realtors; a local trade organization composed of Realtors and Realtor-Associates. Each Board is assigned a geographical region by the NAR.

Broker: A licensed real estate practitioner; the more senior of the two categories of real estate licensees (the other is "salesperson"). A broker is empowered by the state to handle real estate transactions. In this report, "broker" is used generically to refer to all licensees.

California Association of Realtors (CAR): The largest of the 50 State Associations of Realtors, the CAR pre-dates the National Association. With approximately 140,000 members, the CAR membership is about one-fifth of the NAR total.

CAR: California Association of Realtors. (See separate definition.)

Commission: The fee paid for a broker's services.

Commission rate: The method or formula for determining a broker's fees. Traditionally, brokerage rates have often been expressed as a percentage of the selling price of the home, e.g., 6 percent.

Commission split: The fee paid to each broker in a transaction where two brokers cooperate on a sale, and thus split the commission; can refer both to the split rate (e.g., 50/50, half to each broker) or to the split amount, expressed as a dollar amount or as a percentage of the selling price to the cooperating broker.

Cooperating broker: The broker who works with the buyer in the purchase of a home listed by another broker; synonymous with "selling broker." The NAR and its affiliates consider this broker a "subagent" of the seller and thus working for the seller, rather than as an agent working independently for the buyer.

Exclusive agency: One of the three principal types of residential real estate listing contracts (others are "exclusive right-to-sell" and "open" listings). The broker receives a commission if any licensee sells the home within the stated listing period, but does not receive a commission if the seller sells the home.

Exclusive right-to-sell: By far the most common of the three principal types of residential real estate listing contracts (others are "exclusive-agency" and "open" listings). The broker receives a commission if the home is sold during the listing period, regardless of who sold the home.

Licensee: A person authorized by the state to practice real estate brokerage. (See "broker" and "salesperson.")

seller giving the broker certain rights regarding the sale of the home; (2) a home as in (1), information as to which is on or is to be placed on a multiple listing service; (3) the brokerage contract between the seller and the listing broker regarding the sale of a home.

Listing agreement: The contractual relationship between a home seller and a broker (the "listing broker") whereby the seller gives the broker certain rights regarding the sale of the home in exchange for the broker's promised efforts at selling the home. There are three principal types: (1) exclusive right-to-sell; (2) exclusive agency; and (3) open. (See separate definitions.)

Listing Broker: The broker who has a listing agreement with the seller.

MLS: Multiple listing service. (See separate definition.)

Multiple listing service (MLS): A system for sharing information about homes for sale among real estate brokers; often characterized by printed books or sheets of listings.

NAR: National Association of Realtors. (See separate definition.)

NAREB: National Association of Real Estate Brokers. (See separate definition.)

NARESA: National Association of Real Estate Service Agencies. (See separate definition.)

National Association of Real Estate Brokers (NAREB): (Distinguish from "NAREB," used by the National Association of Real Estate Boards (now NAR) prior to 1972.) The trade association of minority real estate brokers. A member is known as a "Realtist."

National Association of Real Estate Service Agencies (NARESA): The trade association of alternative brokers.

National Association of Realtors (NAR): The principal trade association of real estate brokers. More than 700,000 members, known as "Realtors" and "Realtor-Associates," belong. It is composed of 50 state associations and more than 1,800 local Boards of Realtors.

Open listing: One of the three principal types of residential real estate listing contracts (others are "exclusive agency" and "exclusive right-to-sell"). A broker has a nonexclusive right to sell the home which is the subject of the listing and thus receives a commission; but other brokers or the seller may also sell the home resulting in no commission to the broker.

Realtor (always capitalized): The trademarked name for a broker-member of the National Association of Realtors.

Realtor-Associate (always capitalized): The trademarked name for a salesperson-member of the National Association of Realtors.

Salesperson: A licensed real estate practitioner subordinate to a broker; the more junior of the two categories of real estate licensees (with "broker"). A salesperson may handle many aspects of a real estate transaction but certain aspects of a completed transaction are reserved for brokers only. Salespersons

Selling broker: The broker who works with the buyer in the purchase of a home listed by another broker; synonymous with "cooperating broker." The NAR and its affiliates consider this broker a subagent of the seller's agent, and thus working for the seller.

Subagency: A theory of agency law developed for defining the relationship between cooperating real estate brokers. The seller hires as his/her agent the listing broker, who is alleged to in turn "hire" the cooperating or selling broker; this second broker is considered a subagent of the seller under this interpretation, owing to the seller an ill-defined fiduciary obligation of uncertain enforceability.

Traditional broker: A broker who follows the prevailing modes of brokerage practice in his/her community, including the prevailing commission rate and split practices. (To be distinguished from "alternative broker.")