

CHALLENGES FACING REGULATORS (9/24)

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I've been asked to provide my perspective on the role of regulation in this time of change and uncertainty, and there are plenty of both, for several reasons.

- New buyer and seller forms are not understood by many agents and have been criticized by both CFA and the U.S. Department of Justice (DOJ).
- Companies and brokers have been interpreting the Settlement and related NAR rule in different ways, generating conflict among brokers.
- DOJ has not issued a Statement on Sitzer-Moehrl but many expect them to.
- And the Sitzer-Moehrl settlement has not been finalized by the courts.
- Things should be clearer by late January when a new President assumes office but even then, many issues are likely to be unresolved.

To a large extent, the residential real estate industry has been regulating itself, but that is starting to change, with your role becoming ever more important. In our view, you face four important challenges. These are related to contracts, compensation, congestion, and consumer services.

I'll start with buyer contracts, which the Settlement requires. For some time, industry leaders have wanted to mandate buyer contracts, and a number of states require them. But a new NAR rule now requires all Realtors to use them. Unfortunately, many state associations have prepared forms that are unreadable and contain anti-consumer provisions. In May, a law professor evaluated California's buyer and seller contract forms for CFA. This contracts expert found that even she could not understand portions of the forms. She also concluded that many parts of the forms were anti-consumer. DOJ then intervened and persuaded the California Association of Realtors to make significant improvements. But the forms are still difficult for consumers to understand and still include anti-consumer provisions. The law professor and CFA have also evaluated a number of other state association forms and found most to have the same deficiencies.

We urge you to evaluate the forms developed by the industry for your state. Start with the question, can these forms be understood by most home buyers and sellers? Then ask questions such as the following: Is the listing agent and buyer agent compensation separate? Does the form require prior approval of dual agency? And does it require mandatory arbitration in the event of a dispute? CFA has developed lists of criteria for evaluating both seller and buyer contract forms. We urge you to take a look at them.

But even more importantly, we urge you to consider buyer and seller contract forms developed and adopted by eXp. These forms are simple, readable, and are fair to both the industry and to consumers. And eXp is permitting anyone to adapt and utilize their forms. If one of the country's largest residential real estate companies thinks that such forms will work for them, why wouldn't they work for the rest of the industry?

It is our understanding that a couple of states have written specific buyer and seller forms. We urge all states to do so. Forms written with input from both industry and consumers are more likely to be readable and fair to everyone. If you do so, we urge you to start, not with the state association forms but with the eXp forms.

Now onto compensation. In looking at the whole industry compensation system, an increasing number of people are concluding that it is unfair both to the industry and to consumers.

- Commission percentages are fairly uniform and directly related to the sale price. Yet, in general it costs agents no more to sell an \$800,000 house than a \$400,000 one.
- Also, agents are frequently not rewarded for their efforts. One who shows 20 houses earns the same percentage as one who shows only one. And if there's no sale, there's no compensation.
- In addition, the most competent and experienced agents charge no more than new licensees for a sale. I spent three weeks last summer earning a sales license, but that did not prepare me to sell a house. I might be able to do so with the help of my broker and the cooperating agent, but I certainly wouldn't deserve two percent of the sale price.

This is not a liberal-conservative issue. For years, the Wall Street Journal and the Cato Institute have been criticizing industry price-fixing. And so has DOJ. The Sitzer and Moehrl lawsuits in particular have focused public attention on agent compensation. This litigation has emphasized that because of the NAR rule mandating buyer agent compensation offers, neither sellers nor buyers have had a real opportunity to negotiate this compensation. Now because of the Settlement and mandatory buyer contracts, buyers have more of an opportunity to do so.

It appears that most in the industry are trying to comply with both the letter and the spirit of both the settlement and DOJ's statement on the Nosalek case. But some in the industry are still trying to set prices, and those trying to comply are complaining. Let me read you excerpts from one of the broker complaints sent to CFA.

- A buyer's agent called me and asked how much one of my sellers was willing to pay toward her Buyers Agent's fee. I told her that I don't know why this matters since her agency agreement dictates what she's getting paid. However, her buyer is welcome to submit an offer and ask for seller concessions. The agent said: How do I know what to write in for a buyer agency fee if you won't tell me what sellers are willing to pay? What if the seller is willing to pay more than my buyer is agreeing to pay me? I told her I was a fiduciary for the sellers so having her increasing her buyer agency fee to match the seller's contribution is wrong. I again told her that their agreement was their agreement and her buyer could ask for that amount to be reduced in their offer. She told me that their office calls all the listing agents and finds out what sellers are willing to pay to buyer brokers. They then mark above the address what the offer of compensation is so they know what they'd get paid if they write on that property.

We would be very surprised if DOJ didn't make a statement on these issues before the court gives final approval to the Sitzer-Moehrl settlement. But regardless of any intervention, we would urge you to favor price-setting by the marketplace not by industry collusion. This price competition can only exist if consumers and agents negotiate agent compensation independent of any collusion between listing and buyer agents. In its Nosalek statement, DOJ did approve of seller concessions to buyers to help them cover agent

compensation. But these concessions should be requested by buyers in their property offers and should be determined by sellers and buyers, not by their agents.

Importantly, we urge you to recommend that both buyers and sellers do what NAR has long recommended – negotiate compensation of your agent with your agent. Some buyer agents will try to discourage this negotiation by assuring clients that the seller will pay. But you can point out that if buyers negotiate down their agent's fee, they will have a greater ability to negotiate down the seller's list price. Increasingly, consumers will see the sale price and broker compensation as part of the same negotiable cost.

The third challenge is related to congestion – the glut of agents which guarantees that a large majority cannot earn a living income. There are nearly two million agents competing to sell 4-5 million homes a year recently. Doing the math you realize that relatively few can earn a decent income. Annual NAR surveys report that median agent income is around \$50,000. But this sample is biased in favor of the most active agents. CFA's research on 2,000 agents in one area revealed that nearly half had sold only one or no houses in 2022. Glen Kelman recently said that about three-quarters of agents hadn't sold a home in the past year.

That's why a large majority of agents are part-time. They either hold another job, often full-time, or they are retired. Many of these agents, in part because of lack of experience and oversight, are marginally competent. Yet, according to our research, marginal agents with few or no sales capture an estimated 25-30 percent of all commission income. This income drain requires most agents and brokers who are full-time professionals to spend more time finding clients and less time servicing them. With payments to referral agents, the acquisition of clients can also be expensive.

Consumers do not benefit from this marketplace because the glut of agents pressures the industry to maintain 5-6 percent commissions. It also subjects many consumers to substandard service. This is not just our opinion. In 2015, NAR commissioned a detailed study of the industry in which over 7000 members were surveyed. The resulting evaluation was named The Danger Report. Here is one of its major findings, and I'm quoting:

- The real estate industry is saddled with a large number of part-time, untrained, unethical, and/or incompetent agents. This knowledge gap threatens the credibility of the industry. The knowledge and competency gap from the most to the least is very large, due to the low barriers to entry, low continuing education requirements, and the lure of quickly making big dollars.

Many are predicting that recent changes will discourage some marginal agents from continuing to practice.

- These agents will not be able to understand and adequately explain the new rules.
- They will not be able to convince some buyers to sign complex contracts which obligate buyers to provide compensation.
- And they will decide that the increased legal risks, as well as the usual operating costs, are not worth the potential benefits of continuing to practice.

Brad Inman recently guessed that the number of Realtors would decline by one-third.

However, making everything more complex and risky is not the most sensible way to ensure that agents are competent and committed. States need to take more initiative to ensure that agents are able to offer competent services. That begins at the point of entry. Last October we published a study that analyzed the issue of easy entry and made numerous suggestions about the way states could address the issue. Some changes, such as increasing hours of coursework or requiring proctored course exams, may require legislative approval. Yet other measures, including working with testing companies to strengthen state license exams, could usually be implemented by regulators themselves. Almost all states require only a passing score of 70 to 75 percent, and the exams often include questions that could be answered correctly without any course knowledge.

States could also consider requiring some sort of mentoring of agents before they are permitted to sell property. At least one company and many brokers require this mentoring. But according to a report we issued this past January, most brokers will not require effective mentoring unless required to do so. to such a requirement. States could remove or lower these barriers.

The fourth challenge relates to consumer services. There has never been a more important time for you to offer good consumer services. According to surveys, most consumers have never been well-informed about residential brokerage services. Yet now that these services are changing and more complex, home sellers and buyers have even greater needs for good information, advice, and complaint resolution. When we examined your consumer presence and services in 2021, we found that only 11 state commission websites provided adequate consumer information, while 21 of the agency websites effectively ignored home buyers and sellers: The home pages of these websites included no mention of consumers.

My guess is that today, the first number is larger and the second smaller. Yet, we hope that your agency will give even greater consideration to the interests of home buyers and sellers.

What could this consideration include?

- First, a prominent section on your website in which consumers could easily find whether an agent is licensed, whether an agent has been disciplined by regulators, whether and when an agent must loyally represent the interests of their client, what consumer rights and protections exist, and how to complain about unfair agent practices.
- Second, improvement of agency disclosures and their enforcement. In January 2020 we published a report on how these disclosures could be improved, noting those states that required good disclosures. But there's also a question about how rigorously these required disclosures are enforced. The 2020 NAR annual survey of home buyers and sellers reported that only 26% of surveyed buyers indicated that they had received the agency disclosure at the first meeting with their agent.
- And third, greater consultation with consumer and housing advocates on important policy questions. I would agree that it's difficult to find those outside the industry who are knowledgeable about residential brokerage issues but it's important to try, and CFA would be happy to try to help. Even including someone from neighborhood legal services, from a low-income housing group, or from the AG's office on your commissions would help ensure the presence of consumer as well as industry viewpoints.

In conclusion, I would emphasize that our criticisms of the industry have focused on outmoded structures, not on a large majority of brokers and agents. Since speaking at this conference 30 years ago, I've communicated individually with 100s of industry members, and I've found that nearly all of these individuals are well-intentioned, thoughtful, competent, and committed to serving their clients. I look at them as professionals, not just as salespeople, and they have strongly influenced my views. In fact, while it may be presumptuous, I see CFA as advocating not only the interests of home buyers and sellers but also the long-term interests of the many honest, competent professionals in the industry. I believe we share the goals of an industry that;

- functions more competently, honestly, and efficiently,
- is even more highly respected, and
- would no longer have to worry about class action litigation and government intervention.

Such an industry would serve all consumers more effectively and could call itself a true profession.