

A STUDY OF THE USE OF BANKS AS AN ALTERNATIVE
DELIVERY SYSTEM FOR REAL ESTATE BROKERAGE SERVICES

by

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SUBMITTED TO THE DEPARTMENT OF ARCHITECTURE IN PARTIAL
FULFILLMENT OF THE REQUIREMENTS OF THE
DEGREE OF
MASTER OF SCIENCE
IN REAL ESTATE DEVELOPMENT

at the

MASSACHUSETTS INSTITUTE OF TECHNOLOGY

JULY 1988

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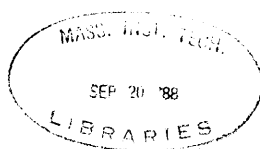


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Submitted to the Department of Architecture on July 29, 1988,
in partial fulfillment of the requirements for the Degree of
Master of Science in Real Estate Development at the
Massachusetts Institute of Technology.

ABSTRACT

This thesis investigates the potential of utilizing banks and bank branches as a means of delivering real estate brokerage services. The thesis will answer the question: Is it advantageous for a new or existing real estate brokerage firm to offer its services through commercial banks, and if so, what methodology or strategy should be used to maximize both market share and profits?

Since banks currently face severe limitations on their ability to own and operate real estate brokerage firms, this study focuses on the feasibility of outside, non-affiliated, real estate brokerage entities contracting with banks to provide real estate brokerage services to the customers of the banks. The thesis is primarily concerned with residential real estate brokerage services, although it is conceivable that commercial real estate brokerage services could also be provided through banks.

After a thorough examination of the real estate brokerage industry both past and present, prior research in the field of real estate brokerage is analyzed, and the legal implications of banks offering real estate brokerage services is explored. Drawing on prior research in the field, this thesis examines the market for real estate brokerage services in banks, and analyzes the results of a survey to determine the willingness of senior bank management to embrace the concept of offering real estate brokerage services. Finally, a theoretical methodology is proposed for providing real estate brokerage services in banks to maximize market share and profits.

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INTRODUCTION

When existing homes are sold in the United States, the sale is usually handled by a state-licensed real estate broker or a licensed salesperson working for a broker. As agent of the seller, the broker or salesperson typically receives a sale's commission, usually a stated percentage of the selling price of the home. In 1986, real estate brokers generated an estimated commission revenue of \$30 billion, about three times that of the securities brokerage industry.

In the United States, the industry comprises approximately 15,000 active real estate brokerage firms. While the nation's largest brokerage firms have increased their gross revenues and dollar volume in recent years, the bulk of U.S. real estate firms continue to be small-scale companies with no more than ten sales agents, revealed a survey by the National Association of Realtors (NAR) [26].

In recent years, there has been an increasing trend toward vertical integration of service delivery among providers of financial services. The trend toward vertical integration is most evident in larger real estate brokerage firms, that expand to provide the wide variety of services that are needed in real estate. Many brokerage firms now provide mortgage finance services, title searches, appraisals, insurance, and settlement services. As large real estate firms expand their services, competition for brokerage-related services will likely intensify.

The trend toward vertical integration of financial services

has not been completely uniform, since banks have been prevented by law from operating real estate brokerage firms. Recently, bank regulators and certain members of Congress have attempted to expand permissible bank activities into such areas as securities underwriting, real estate development, real estate investment, and possibly real estate brokerage.

It remains unclear whether banks will be permitted to own and operate real estate brokerage firms in the near future. Although banks cannot own and operate real estate brokerage firms, it is permissible under current law for non-affiliated real estate brokerage firms to contract with banks (via lease arrangements) to provide brokerage services to the bank clientele.

This thesis examines the residential real estate brokerage industry in the United States and, drawing upon prior research as well as field study, analyzes the feasibility, advantages, and disadvantages of a new or existing real estate brokerage firm offering its services through commercial banks via a percentage lease or other contractual arrangement.

CHAPTER ONE: THE REAL ESTATE BROKERAGE MARKET

Background

The primary function of real estate brokerage is to match buyers and sellers in the housing market. The residential real estate broker provides information about the steps in the purchase and sale transaction, negotiates the terms of sale, and most importantly, provides information about the market and about houses being offered for sale. Brokers usually have expertise and information that consumers lack.

Most home sellers use the services of a real estate broker. The broker with whom they contract is referred to as the listing broker, and is compensated according to the listing contract. A typical listing contract might specify that, if the home is sold within a given period, the broker will receive 6 percent of the selling price as a commission for achieving the sale. The listing contract also will specify the price which the seller hopes to obtain; however, the actual selling price is frequently lower than the initially proposed price.

Listing brokers perform a variety of tasks designed to facilitate the sale of a home. One of the most important of their tasks is to list the home in the local Multiple Listing Service (MLS), which is generally owned and operated by an association of brokers. Most brokers participate in the MLS system, although participation in most areas is not mandatory. The MLS is an information sharing and exchange mechanism, the use of which is reserved for its member brokers. The MLS is a

means of informing members, who are potentially cooperating brokers, of the seller's desire to sell. The listing broker will describe the property, the asking price, any unusual features, outstanding mortgages, etc., and will indicate his or her willingness to share the commission with any cooperating broker who finds a suitable buyer. The listing broker sets the percentage of the total commission which will be offered in this arrangement, which may amount to half of the total commission. In addition to utilizing the MLS system, most listing brokers advertise homes for sale in local newspapers, advertise in specialized homes publications, and hold homes "open" on weekends to attract prospective buyers.

Home buyers often work with real estate brokers to find suitable homes to purchase. While brokers typically inform prospective buyers of their own listings first, they will then turn to the local MLS to find additional listings which may meet the buyer's needs. If the buyer makes a selection, an offer to purchase the home is made through the broker. A process of negotiation often follows, with counter-offers relating to price and other contractual terms changing hands through the intermediation of the broker.

Once the seller and buyer agree to price and terms, the transaction is put in the form of a contract, and then enters into a stage referred to as escrow. During the escrow period, an escrow agent (in some states, the real estate brokerage firm itself) will hold the contract and a specified deposit referred to as earnest money to bind the buyer during a period

while the buyer seeks to obtain financing or funds needed to close the transaction. The listing and cooperating brokers will generally monitor the progress of the buyer in procuring financing. At the close of escrow, if financing has been obtained and the other requirements in the contract have been met, title to the property transfers to the buyer, and the funds, usually including the brokers' commissions, are distributed by the escrow agent [27]. In some states, an attorney representing one or both parties serves in lieu of an escrow agent to close the transaction and disburse funds.

History of Real Estate Brokerage

The date of the first real estate brokerage business is unknown; however, real estate brokerage firms were operating in New York before 1800. Through the rapid growth of cities in the 1840's, real estate brokerage in the larger cities became a recognized, established business [4].

In 1847, the earliest known formal organization of real estate brokers, a local real estate board, was formed in New York for the purpose of exchanging information among brokers. The first state associations of real estate boards were formed in the early 1900s [4]. The National Association of REALTORS (NAR), was founded in Chicago, Illinois in 1908 by 120 brokers representing 19 realty boards and one state association (that of California). Until 1972, when it changed its name to the current form, the organization was known as the National Association of Real Estate Boards (NAREB). By 1926 the organization included nearly 25,000 members. However,

the Depression brought a sharp decline; membership fell to less than 9,000 by 1935. Membership increased slowly thereafter, gaining momentum after World War II. The NAR now has over 700,000 members, 85 percent of whom are primarily engaged in residential brokerage. The NAR currently describes itself as "the largest trade and professional association in the nation" [27].

The NAR is the parent organization for a tripartite trade organization operating on national, state, and local levels. Under a three-way agreement among the different levels, the NAR grants local boards and state associations the use of the term Realtor in exchange for the boards' and state associations' agreement to abide by and enforce the NAR Code of Ethics within their jurisdictions [27].

Regulation of the Real Estate Brokerage Industry

The real estate brokerage industry is regulated primarily at the state level, although all real estate brokers must abide by various federal regulations pertaining to fair housing practices and settlement procedures. All 50 states and the District of Columbia require real estate brokers and salespersons to be licensed. The license statutes form the framework for state control of the brokerage industry, and delineate the licensure prerequisites, the prohibited practices for which licenses may be suspended or revoked, and the structures and powers of the regulatory agency.

All states have established two separate categories of real

estate licenses: one for salespersons and one for brokers. In order to operate a real estate brokerage firm, an individual must have a broker's license; therefore, applicants for broker licenses usually are required to have proportionately more education and experience than those for salesperson licenses. The prerequisites for licensure vary considerably from state to state, ranging from no education and no experience requirements for either class of license in the District of Columbia, to 240 classroom hours and three years of experience for broker applicants in Pennsylvania.

States vary in their willingness to accept the credentials of licensees from other states. Thirty states have no reciprocity agreements. Most of the remaining states participate in reciprocity agreements with a small number of jurisdictions; in many cases waiving only a portion of their requirements for transferees.

In addition to adhering to state regulations, real estate licensees who are members of NAR, must abide by the NAR Code of Ethics. Local real estate boards apply and enforce the Code of Ethics through Board of Grievance Committees, Professional Standards Committees, and Arbitration Panels.

Estimated Size of the Real Estate Brokerage Market

There are no accurate figures on the size of the real estate brokerage market either in terms of commission revenue or transaction volume. Even the NAR maintains only records of home sales of existing properties and average sale prices, and does not take into account new home sales or properties sold

without the services of a real estate broker. The U.S. Census Bureau has a Standard Industrial Classification (SIC) code number, 6531, which comprises all real estate related activities (brokerage, management, appraisal, investment, etc.). Unfortunately, they do not have data available on total industry revenue, and even if they did, it would be difficult to extract only the brokerage portion of the revenue.

The only published estimate available on total size of the real estate brokerage market is provided by the Roulac Real Estate Consulting Group of Deloitte Haskins & Sells in their annual publication Roulac's Top Real Estate Brokers: Facts and Figures on the Nation's Leading Brokerage Firms. The 1987 edition of the Roulac publication, which is based on 1986 data, estimates the total transaction volume handled by real estate brokers in the United States in 1986 at \$500 billion. They estimate the total revenue generated by real estate brokers in the United States in 1986 at \$30 billion [26]. No estimate was made as to what percentage of the \$30 billion in revenue was generated from residential transactions and what percentage was generated from commercial transactions.

Using data available from the U.S. Census Bureau and the NAR, one can make several simplifying assumptions to obtain an estimate of the size of the residential real estate brokerage market. First, an estimate must be made of the total aggregate home sales for new and resale homes. This figure must then be discounted to allow for the percentage of homes sold for sale

by owner (i.e., homes sold without the services of a real estate broker). Then, the discounted aggregate home sales figure must be multiplied by an assumed commission rate to obtain the total residential real estate brokerage market revenue. Based on the calculations in Table 1 on the following page, the total market revenue for residential real estate brokerage services in 1987 can be estimated at \$24.8 billion.

Major Firms in the Real Estate Brokerage Industry

In addition to providing the only published estimate of the size of the real estate brokerage market, the Roulac report provides the only consistent annual overview of major firms in the real estate brokerage industry. According to the 1987 edition, approximately 15,000 active real estate brokerage firms exist in the United States. In 1986, the 25 largest nonfranchise firms and the seven largest franchise networks together handled approximately \$252 billion in transaction volume, or more than half of the industry's estimated \$500 billion in transactional volume (see Tables 2 and 3). While these 32 large firms accounted for more than 50 percent of the industry's volume, the vast majority of real estate brokerage firms continue to be small-scale companies with no more than ten sales agents.

Results from a 1,200 firm random survey conducted by the NAR indicate that 43 percent of real estate companies nationwide have five sales agents or less, while an additional 23 percent of firms have six to ten agents. Thus only 34

TABLE 1

Calculation of the Estimated Size of the 1987
Residential Real Estate Brokerage Market

1987 New Home Sales (2)		Average New Home Price (1)		Aggregate New Home Sales
671,000	X	\$127,000	=	\$85.2 Billion
1987 Home Resales (2)		Average Resale Home Price (2)		Aggregate Resales
3,526,000	X	\$106,300	=	\$374.8 Billion
		TOTAL AGGREGATE SALES		\$460.0 Billion
Total Aggregate Sales		10% Homes Sold By Owner (3)		Adjusted Total Sales
\$460.0 Billion	-	\$46.0 Billion	=	\$414.0 Billion
Adjusted Total Sales		6% Commission Rate (4)		Estimated Total Revenue
\$414.0 Billion	x	.06	=	\$24.8 Billion

Data sources for Table 1:

- (1) U.S. Census data for 1987
- (2) National Association of REALTORS data for 1987
- (3) Estimate from Carney [4] doctoral dissertation pg. 32
- (4) Estimate based on industry research

percent of firms have eleven or more sales agents, and only 4 percent of brokerage firms have more than fifty sales representatives. According to the NAR survey, 89 percent of firms operate from one office, 7 percent from two offices, most of the remaining 4 percent from ten or fewer offices; and less than 0.5 percent operate from more than ten offices [26].

TABLE 2

LARGEST FRANCHISE BROKERAGE FIRMS IN THE U.S. IN 1986

Rank	Company Name	Gross Revenues (millions \$)	% Residential
1	Century 21, International	2,037.0	86%
2	RE/MAX International, Inc.	815.9	N/A
3	Electronic Realty Associates	655.0	85%
4	Better Homes and Gardens	424.0	100%
5	Execu-Systems, Inc.	59.2	85%
6	Better Homes Realty	23.5	93%
7	Key Associates, Inc.	19.0	90%
8	Coast-to-Coast Properties	12.2	92%

Source: Roulac's Top Real Estate Brokers - 1987: Facts and Figures on the Nation's Leading Real Estate Brokerage Firms

TABLE 3

LARGEST NONFRANCHISE BROKERAGE FIRMS IN THE U.S. IN 1986

Rank	Company Name	Gross Revenues (millions \$)	% Residential
1	Coldwell Banker Real Estate	1,155.6	54%
2	Merrill Lynch Realty, Inc.	692.0	81%
3	New America Network, Inc.	462.0	10%
4	Royal LePage Ltd.	350.0	60%
5	Grubb & Ellis Company	319.8	27%
6	The Office Network, Inc.	285.0	none
7	Cushman & Wakefield, Inc.	198.0	N/A
8	Weichert Company, Realtors	194.0	100%
9	Johnstown American Companies	145.5	3%
10	Schlott Realtors	131.4	100%
11	Goldman Sachs & Company	122.5	none
12	Colliers International	121.5	none
13	Long and Foster Real Estate	112.0	92%
14	Fred Sands Realtors	103.8	71%
15	Shannon & Luchs, Realtors	73.1	N/A
16	O'Connor, Piper, & Flynn	70.0	86%
17	Great Western Real Estate	59.1	95%
18	Rubloff, Inc.	58.0	10%
19	Marcus & Millichap, Inc.	55.3	none
20	The Keyes Company	53.3	65%
21	Baird & Warner	52.8	80%
22	Cornish & Carey Commercial	50.0	60%
23	Edward S. Gordon Co., Inc.	50.0	none
24	Mount Vernon Realty	45.9	91%
25	Cross and Brown Company, Inc.	45.0	10%

Source: Roulac's Top Real Estate Brokers - 1987: Facts and Figures on the Nation's Leading Real Estate Brokerage Firms

Pricing of Home Brokerage Services

Critics of the real estate brokerage industry have said that the commission rates for the sale of residential real estate in most markets are too uniform to be determined by competitive forces. The evidence available, while not conclusive, tends to support the hypothesis that the price of real estate brokerage services is noncompetitively high. Studies of brokerage fees nationwide also indicate that the commission rates contracted for and ultimately paid generally are highly uniform within any geographic region [27].

A survey of consumers conducted for the Federal Trade Commission (FTC) in 1979 indicated that 85 percent of sellers surveyed alleged they were quoted a commission rate of either 6 percent or 7 percent by the broker whom they used, and ultimately 78 percent paid either 6 percent or 7 percent (see Table 4). Sample studies by the U.S. Department of Urban Development indicate that in 11 of 16 cities surveyed, 80 percent or more of the commission rates actually paid were 6 or 7 percent [27]. Carney [4] examined over 7,000 observations on actual commission rates for 23 major U.S. cities and for all 50 states (73 total market areas) and found that high proportions of commission rates occurred at a predominant market area modal rate, usually at 6 percent or 7 percent.

Although brokerage commission rates tend to be the same within a given market area, several studies show that commission rates may be lower on: (1) the sales of higher-priced homes, (2) sales of new relative to existing homes, and

(3) non-co-op relative to co-op sales (a co-op sale involves the cooperation of two brokers, one acting as the listing broker and the other acting as the selling broker). Carney [5] proved this hypothesis by regressing commission rates on the selling price of the home and on dummy variables for existing versus new homes and for co-op versus non-co-op sales. The results of his regression yielded coefficients which were all significant at the 1 percent level.

TABLE 4

National Sample of Real Estate Brokerage Commission Rates
Based on 1979 FTC Consumer Survey of Home Sellers

<u>Commission Rate</u> <u>(Percentage)</u>	<u>Percentage of Total</u>	
	<u>Quoted</u>	<u>Actual</u>
Less than 5%	3.4%	6.6%
5%	4.4%	5.6%
5%-6%	---	2.8%
6%	52.7%	49.9%
6%-7%	1.9%	1.9%
7%	31.9%	27.9%
Greater than 7%	5.0%	5.0%

For many years, the total aggregate real estate commissions generated in the United States have grown at a rate much higher than the rate of inflation. The unusually high growth rate of aggregate commission fees was pointed out both by the FTC in a 1983 study [27] and by Crockett in 1984 [8]. The total dollar amount of gross commissions increased by an average of at least 615 percent between 1950 and 1979, a

growth rate of nearly twice that for all white-collar wages during the same period, and nearly three times the officially acknowledged increase in consumer prices (215 percent) [27].

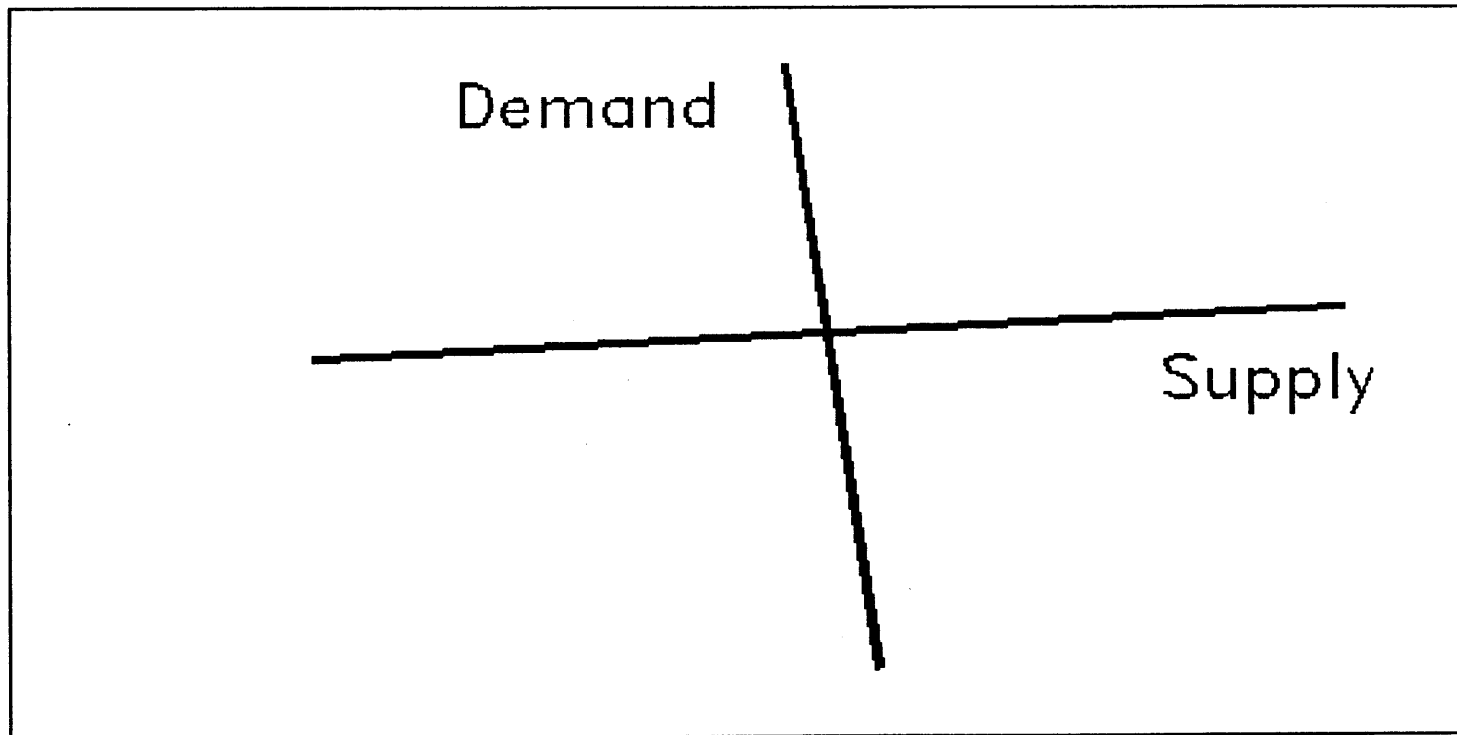
The aggregate market and pricing for residential real estate brokerage services may be portrayed (as in Figure 1) as having relatively inelastic demand, because consumers lack information, and relatively elastic supply, because entry on a small scale is easy. In addition, the market has a relatively stable and horizontal supply, with a long-run upward trend in demand caused by increases in the number of households and real income, but with unanticipated fluctuations in short-run demand, because of changes in mortgage market conditions [4].

Paradoxically, the supply curve for real estate brokerage services shows that the prospect of a skillful broker or salesperson being able to earn a high income in real estate brokerage attracts more agents than are necessary to accomplish efficiently the function of brokerage. This inefficiency in real estate brokerage was documented by Crockett [7], who concluded that the traditional absence of price competition among brokers probably has led to an inefficiently large commitment of resources to the brokerage industry, supported by excessive rates for consumers of brokerage services.

A relatively recent phenomenon in the real estate brokerage industry has been the advent of the "alternative" real estate broker or "discount" broker. These firms' business practices differ substantially from the norm in either commission rates

FIGURE 1: AGGREGATE MARKET AND PRICING OF HOME BROKERAGE SERVICES

Commission Rate (Price)



Quantity

or type, level, or variety of services offered. The 1983 FTC study [27] revealed that approximately 2 percent of reported transactions involved the services of firms which could be characterized as discount brokers.

Discount brokers generally provide limited services at costs substantially lower than full service brokers. They typically charge a flat fee for their services. In the past, the growth of discount brokerages had been blocked by local real estate boards that denied these firms access to the MLS. Today however, it is illegal to deny a discount real estate brokerage firm access to an MLS system, and both the U.S. Department of Justice and the Federal Trade Commission are quite willing to assist discount brokerage firms in gaining full access to the MLS.

The problems evident in the fee structure of real estate brokerage could be resolved by the introduction of price competition. Although stock brokerage is much less dependent upon cooperation among brokers than real estate brokerage, the success of Charles Schwab & Company, a discount stock brokerage, has demonstrated that the introduction of the discount brokerage concept into a previously non-price-competitive environment can affect changes in that environment and be successful as well. As competition in real estate brokerage increases from multioffice, nationally-based firms; vertically integrated financial institutions; and the effective use of technology; many brokerage firms may choose to cut their prices in order to gain a larger market share.

Emerging Trends In Real Estate Brokerage

The Roulac Real Estate Group in the 1986 and 1987 editions of their annual survey of top real estate brokerage firms noted the following emerging trends in the industry: (1) The trend toward nationally oriented real estate brokerage markets as major financial institutions promote "one-stop" shopping centers that include brokerage services; (2) the continued trend toward vertical integration of service delivery as large real estate firms, as financial institutions and conglomerates expand their services; (3) the trend toward increased competition from financial services companies; (4) the computerization of information and analysis, as the technological revolution expands into real estate brokerage; 5) the development of electronic mortgage networks; and (6) the increasing demand for competitive pricing structures [26].

Analyzing these trends leads to the conclusion that offering real estate brokerage services in bank branches is a natural direction for growth in the industry. In an attempt to provide "one-stop" financial shopping centers, a significant number of banks have vertically integrated by offering a variety of financial services. Providing real estate brokerage would be a logical addition to the financial services already being provided by many banks. In addition, the development and growth of electronic mortgage networks will increase competition among lenders for home mortgage loan origination. Through referrals, banks offering real estate brokerage would have a higher probability of capturing home loan business.

CHAPTER TWO: PRIOR RESEARCH ON REAL ESTATE BROKERAGE

For an industry of the magnitude of real estate brokerage, a relatively small amount of empirical research and analysis has been performed. The industry trade organization, the National Association of Realtors (NAR), maintains data on the number of Realtor members within a given jurisdiction, the number of home sales and the average selling prices of homes in various areas throughout the country, and from time to time, conducts surveys of its membership to determine such things as income, expenses, and profits of real estate brokerage firms. The NAR has done few, if any, studies in the area of market share maximization strategies, estimating demand for real estate brokerage services, pricing strategies for properties, or examining the effects of price competition on the industry.

The majority of quantitative research performed on real estate brokerage has been conducted by the academic community; primarily by faculty members from the finance and economics disciplines at colleges and universities. One notable exception is the work done by the Roulac Real Estate Consulting Group in their annual study of the U.S. real estate brokerage industry.

The primary periodicals for prior research in the real estate brokerage field are the American Real Estate and Urban Economics Association (AREUEA) Journal, and to a lesser extent, Real Estate Review. Recently, a new publication, the Journal of Real Estate Research, has begun to publish articles

dealing with real estate brokerage.

The following is a brief topical summary of prior research on real estate brokerage:

Market Share and Broker Income

The most detailed recurring survey of the U.S. real estate brokerage market is the Roulac Real Estate Consulting Group's annual publication, which is currently in its sixth edition [26]. This publication surveys over 200 of the largest real estate brokerage firms and lists for each of the firms: gross revenues, number of offices, number of agents, number of transactions, services mix, business growth, corporate management, and a one paragraph company profile. The Roulac publication is valuable for looking at the nation's largest real estate brokerage firms; however, it only surveys the 200 largest of an estimated 15,000 firms in the United States, making it difficult to draw conclusions for the industry as a whole.

The Roulac study makes the following observations: (1) Brokerage is still a fragmented business with smaller firms generating almost half of the total volume, although it is becoming less fragmented each year. (2) In 1986, real estate brokerage firms accounted for a total transaction volume of approximately \$500 billion; the 25 largest nonfranchise firms and the 7 largest franchise networks combined handling approximately \$252 billion or more than 50% of the industry's total volume. (3) Real estate brokerage is becoming an increasingly competitive business, and those firms that fail

to recognize that new tools and a higher degree of sophistication are required today risk obsolescence. (4) There is an increasing trend toward vertical integration of service delivery, as well as an increasing emergence of national real estate markets as large financial services firms enter the industry. (5) There is a growing demand for competitive pricing structures.

More detailed information on industry income and expenses is available through the NAR publication entitled Real Estate Brokerage 1985: Income, Expenses, & Profits, which is the fourth in a series of reports on income, expenses, and profits of residential real estate brokerage firms. Data for the report was gathered from 342 brokerage firm owners who attended a seminar given by the Realtors National Marketing Institute on "How to Manage a Real Estate Office Profitably: Managing for Profit and Growth." The study may be somewhat biased however, since the course attendees came from larger, and presumably better run firms than the typical residential brokerage operation. A few of the highlights of the 1984-85 study are: (1) The average gross income of all real estate firms in the survey was \$708,959, up 4.6 percent from the 1979-80 survey. (2) Total expenses (after commissions) averaged \$246,881, up slightly from the 1979-80 survey. (3) Average pre-tax net income of the firms in the survey was \$34,903, up 42.3 percent from the 1979-80 results. Firms of all sizes were represented in this study, however, the average number of salespeople in the firms surveyed was 29.6 and the median was 14.0 [21].

Several articles have appeared in the AREUEA Journal that pertain to the real estate brokerage market and broker income. Frew and Jud [12] concluded that a national franchise affiliation appears to contribute an extra \$929,464 to firm sales. Jud [16] found that the tendency for buyers of real estate to seek the assistance of a broker was determined by the buyers' prior knowledge of the housing market, and that the demand for home sellers to engage the services of a real estate agent was principally dependent upon transaction costs in the housing market, including the opportunity cost of the sellers' time.

One of the more interesting studies by Colwell and Marshall [6], analyzed the factors which determine the market share of listings and the market share of sales for brokerage firms. Their study examined the effects on market share per salesperson of obtaining listings and the market share per salesperson of making sales of six selected brokerage firm characteristics. The significant factors affecting either market share per salesperson in listings or market share per salesperson in sales are: (1) quantity of display advertising, (2) the number of salespeople in the firm, and (3) whether or not the firm is a franchise. The number of salespeople was the most consistently significant variable. The presence of a franchise and the quantity of display advertising were occasionally significant. The other three characteristics, classified advertising, yellow pages advertising, and open houses, all did not significantly affect market share. The

study concludes with the idea that studies of brokerage firms may be mis-directed if one accepts an alternative proposition that the brokerage firm is relatively unimportant, and that the important human capital and goodwill belong to the salesperson. If this alternate proposition is correct, then empirical work should proceed to determine the impact of salesperson characteristics on market share.

A recent article in the Journal of Real Estate Research, by Richins, Black, and Sirmans [24] analyzed marketing strategy concepts as they apply to real estate brokerage firms. The authors believe that firms follow one of three strategic orientations with respect to revenue generation: a balanced strategy (equal weight to selling and listing), an autonomous strategy (little dependence on other firms), or a selling strategy (emphasize selling over listing). The article also analyzes the effectiveness of marketing mix strategy variables, such as service level and advertising, in achieving market share. The analysis indicates a range of effectiveness in the strategy variables, depending upon the strategic orientation adopted by the firm. Of over 20 marketing mix variables analyzed, the most significant are: selling price of listed property (relative to average value of properties listed by the firm), geographic dispersion (distance from real estate office to the listed home), and the selling price of the property sold. From their research, the authors draw the following conclusions: (1) Firms should locate their offices near the areas in which they would like to sell property. (2)

The more properties a firm has sold in an area, the greater the probability of making subsequent sales in that area. (3) It is easier for a brokerage firm to sell less expensive properties (relative to the average value of properties sold by the firm) than more expensive properties. (4) Service level is negatively related to sales. (5) The value of advertising depends upon a firm's strategic orientation. (6) Franchise affiliation has a positive effect on market performance.

In addition to studies conducted on the market share of the firm, a few researchers have analyzed the performance of the salespeople within the firm. In a 1985 survey of members of the Illinois Association of Realtors conducted by Follain, Lutes, and Meier [11], 20 factors thought to determine real estate salesperson success as measured by income were analyzed via multivariate regression. Their findings included: (1) A person who works 50 hours per week can expect to earn more than 30 percent more than a person who works only 40 hours per week. (2) Income increases substantially with years of experience in the early years of a career (over 20 percent per year for the first five years), but then increases flatten out for the veteran with more than ten years of experience. (3) Men and women with similar traits who work the same amount of time earn the same. Although the findings of Follain, Lutes, and Meier are interesting, some of their observations may be partially explained by the fact that salespeople who do not succeed in the business may leave after a brief period and those that are successful go on to earn higher incomes.

Brokerage Commission Rates

Several studies have been completed on real estate brokerage commission rates which attempt to address the issue of whether or not price-fixing exists. The Federal Trade Commission (FTC) Report, The Residential Real Estate Brokerage Industry [27], reached the following conclusions with respect to brokerage commissions: (1) Many consumers are unaware of the basic aspects of selecting a real estate broker, including the fact the the brokerage fee is negotiable. (2) Commission rates in all markets tend to be roughly uniform from sale to sale. (3) Brokers that have attracted many listings with advertising low commission fees might encounter problems in cooperatively selling their listings.

Since discount brokers may offer cooperating brokers less compensation than that provided by traditional brokers, it is alleged that traditional brokers steer their buyers away from homes listed by discount brokers. Discount brokers charging less than the prevailing commission rate, therefore, may find that while competition in price facilitates the acquisition of listings, it often hampers efforts to sell those listings. This in turn makes price competition an unsuccessful strategy, and in the FTC's opinion is the principal explanation for the uniformity of commission rates in most local markets.

Carney [5] concluded that brokerage commissions are lower for higher-priced homes, new relative to existing homes, and non-co-op sales relative to co-op sales. In a separate study consisting of over 7,000 observations of home brokerage

commission rates, Carney [4] concluded: (1) Brokerage commissions tend to be uniform or concentrated at a single modal rate of 6 percent or 7 percent of the selling price of a home. (2) The distribution of rates is negatively skewed, suggesting some discounting from the modal rate. (3) Commission splits tend to be uniform at a 50-50 ratio.

In a study conducted at the University of Houston, Crockett [7] discovered that the absence of price competition among brokers may have led to an inefficiently large commitment of resources to the brokerage industry, supported by excessive rates for consumer brokerage services. The results he observed stem from the way that competitive pressures emerge when price competition is largely suppressed. Crockett believes that the key to enhanced price competition probably lies in increasing accessibility to the market information maintained by the multiple listing service (MLS), and that one step in that direction is to insure that discount brokers may participate in the MLS. He concludes with the suggestion that the natural outcome of increasing accessibility to market information might be to open the MLS to non-brokers, since providing access to information on a fee basis, without tying it to other services, is consistent with efficiency in transacting.

In another article, Crockett [8] noted that brokerage firms attempt to attract market share by means of services rather than price; and as a result the industry is characterized by an excessively large agent force made possible by an excessive commission rate. Also, he feels that when commission rates are

fixed the competition among brokerage firms can be expected to lead to excessive expansion in number of sales agents. Finally, Crockett concludes that consumers will eventually benefit from the ability to choose between full-service, relatively costly brokerage firms, and other alternatives at different prices.

Another study relating to brokerage commission rates, by Zorn and Larsen [30], analyzes the incentive effects of flat-fee and percentage-based commission systems from the perspective of the economic theory of agency. The study concludes that flat-fee and percentage-commission systems do not lead to an optimal amount of search on the part of the real estate agent. Also, the flat-fee commission system has inferior incentive effects when the seller wishes to sell for the highest bid found in the search process.

In their textbook, Goldberg and Chinloy [14] apply economic theory to brokerage commission rates. Economic theory suggests that the lower the commission rates, the higher the number of listings. The authors believe that when a broker raises the commission rate, house listings will fall. The extent of the fall depends upon the revenues and costs of changing the commission rate.

Consumer Preferences and Attitudes toward Brokers

The largest comprehensive survey of buyer and seller preferences in selecting a real estate broker was conducted by the Federal Trade Commission (FTC) [27]. The FTC study of buyers concluded that: (1) The two primary ways that buyers

become aware of the agents that handle the purchase of their homes are that the agent was a friend or relative (26.9 percent of buyer respondents), and that the agent/firm was recommended to them (22.9 percent of buyer respondents). (2) The single most important reason buyers use real estate agents to look for a home is to gain access to information on the widest assortment of homes. (3) The single most important reason people looking for a home might not inspect homes listed with discount firms is that they believe the firms are not reputable or ethical (27.8 percent of buyer respondents).

The FTC study of home sellers concluded that: (1) The most important reasons that homes are listed with real estate firms are to sell the home quickly (19.5 percent of seller respondents) and to free the sellers from the time commitment and effort of selling the homes themselves (13.8 percent of seller respondents). 2) The most important reasons for listing with a particular agent are the experience and reputation of the agent/firm (18 percent of seller respondents), and that the agent was a friend/relative (13 percent of seller respondents). Not surprisingly, due to the lack of price competition, only 2 percent of seller respondents mentioned commission fees as a reason for choosing a particular listing broker. 3) The single most important reason sellers might not list with a discount broker is the lack of services (21.6 percent of seller respondents). 4) When asked how real estate commission rates are determined, 34.3 percent of seller respondents believed that rates were determined by law or by the Board of Realtors.

Blair and Rossi [3] polled 620 consumers who had purchased a home in the past year to ascertain the brokerage services they consider most important and the type of brokerage firm they would expect to offer such services. They found that most consumers believe there is or would be no difference between services provided by local independent firms and nationally affiliated firms. Having salespeople who are willing to spend time with the customer was the most valued service. Many of the technological factors (i.e., showing video presentations) were not highly valued by customers. Commission rate was ranked fifteenth in importance out of twenty-one categories of services offered by brokers. Finally, when the respondents were asked whether a seller should choose a nationally affiliated broker or a local independent broker, 47 percent believed a local independent broker should be selected compared with 20 percent who responded that the seller should select a nationally affiliated broker.

One study directly pertinent to this thesis was performed by Kehrer [17]. Kehrer's study was based on an analysis of the Survey of Consumer Finance, a 5,000 person survey commissioned by the Federal Reserve Board. In his 1985 study, "Consumer Attitudes toward Buying and Selling Real Estate through Banks and Thrifts", Kehrer found that a substantial number of households are interested in buying and selling real estate through banks and thrifts. He estimates the immediate market for the services to be almost 8 million households (10 percent of all households). The potential market is almost one

household out of every five. Kehrer also noted that the market for real estate brokerage services in banks and thrifts is not an upscale market. That is, three-fourths of the households interested in doing their real estate transactions in banks and thrifts are in the middle and lower income bracket of people under 55, which makes up 65 percent of the homes in the United States.

Property Pricing Strategies and Time on the Market

A recent study by Miller and Sklarz [19] dealt with property pricing strategies. In their study of large high-rise centrally-located condominium sales, they attempted to determine whether or not asking prices are an indicator of value to buyers. The basis for their study was previous research done on consumer goods, which had indicated that pricing strategies may influence perceptions of quality. Their study concluded that the existence of an optimal pricing strategy for large-ticket heterogeneous markets, like real estate, is much easier to assert than to prove statistically. The study also demonstrated a positive correlation between longer selling time and property price relative to the value estimate. Additionally, a nonlinear relationship was found where asking a larger list price has marginally decreasing impact on selling price, as one moves further above the value estimate. Miller and Sklarz believe that if any optimal pricing strategy can be inferred, it seems to be to ask (or list) at a price at least equal to or above that of the typical pricing spread for other similar property.

Belkin, Hempel, and McLeavey [2] concluded that time on the market is an important factor in describing market behavior. The study shows that brokers do a good job in negotiating list price. Within submarkets, a large percentage of properties sell close to list price and within a short time on the market. Time on the market data regressed against house features yields low predictability, demonstrating that house features cannot be used to predict time on market with accuracy.

Effects of a Multiple Listing Service

Frew [13], in a recent study of MLS systems, concluded that although size advantages enable larger brokerage firms to sell a greater portion of their listings, the evidence indicates that these advantages also create incentives to avoid commission splits by withholding the listings from the MLS. Thus, to save resources through improved efficiency, a significant amount of resources would be consumed in enforcing compliance with compulsory MLS participation. Frew concludes that enforcement problems must be carefully considered when drawing conclusions about the net benefit of government intervention to mandate compulsory MLS participation.

The effects of introducing an MLS system were explored by Wu and Colwell [29] in their study, "Equilibrium of Housing and Real Estate Brokerage Markets Under Uncertainty." The introduction of an MLS system was found to have several important effects. The MLS does cause housing value to

increase, but its effect on the commission rate is indeterminate. MLS brokers, on the average, are found to undertake more search for both buyers and listings than will non-MLS brokers. The primary reasons relate to the greater efficiency of search in the MLS context. Although the methodology of the Wu and Colwell study is not completely clear, it appears that they may have neglected to consider possible appreciation in home values when reaching the conclusion that the introduction of an MLS system causes an increase in home values.

Effects of State Licensing Regulations

A detailed description of the state real estate licensing requirements can be found in the 1983 FTC study, The Residential Real Estate Brokerage Industry [27]. The FTC study provides a tabular synopsis of state education requirements, experience requirements, continuing education requirements, and other application requirements. The report also contains information on examination results, residency requirements, reciprocity agreements, license fees, and state statutes and regulations.

Johnson & Loucks [15] examined entry barriers within the real estate brokerage industry to determine the effect of differing state entry requirements on the supply of practitioners, on earnings, and on quality of service provided. Their study concludes: (1) Regression results provide some support for the hypothesis that increased regulation will limit the supply of real estate licensees per 1,000 population. (2) No support was found for the premise

that higher earnings will result from fewer licensees per 1,000 population. (3) Quality of service does increase as a result of fewer licensees per 1,000 population: a 10 percent reduction in the number of licensees will yield a 5.7 percent decrease in complaints per transaction lodged with the real estate commission. (4) The real estate industry does not appear to be acting as cartel by enacting self-serving occupational licensure regulations to restrict supply and raise industry earnings.

CHAPTER THREE: BANKS AND REAL ESTATE BROKERAGE

Historical Role of Banks in Real Estate

Historically, national banks, bank holding companies, and nearly all state-chartered banks have not been permitted to own and operate real estate brokerage firms. The prohibition on banks owning and operating real estate brokerage firms still holds true today, although Congress is currently considering whether banks should be permitted to engage in several real estate related activities, including brokerage.

Over the years, banks have begun to take a more active role in many aspects of the real estate business. Today, most banks have extensive real estate lending operations that make home mortgage loans, permanent loans on income producing property, and construction loans. According to the U.S. Department of Housing and Urban Development's "Survey of Mortgage Lending Activity" for January 1988 [28], commercial banks now account for 46 percent of all long-term mortgage loan originations (except land) and 80 percent of all construction loans (see Table 5).

In addition to real estate lending operations, the larger institutions (i.e., Citibank) have developed their own real estate investment management departments to provide real estate investment expertise on a fee basis to institutional clients. Also, Bank of America, Mellon Bank, and Wells Fargo Bank currently sponsor real estate investment trusts. However, banks have been prohibited from making most direct real estate investments, participating in real estate joint ventures, and in operating real estate brokerage firms.

TABLE 5

Breakdown of the Market Share for Long Term-Mortgage Loan
Originations (Except Land) and Construction
Loan Originations

	Commercial Banks	Savings & Loans	Mortgage Companies	Other Sources
Long-Term 1-4 Family Nonfarm Homes Loans	26%	39%	27%	8%
Construction Loans for 1-4 Family Nonfarm Homes	58%	29%	9%	4%
Long-Term Multifamily Residential Loans	19%	52%	7%	22%
Construction Loans for Multi- Family Residential Properties	76%	12%	2%	10%
Long-Term Nonfarm, Non- Residential Property Loans	80%	9%	0%	11%
Construction Loans for Nonfarm, Non- Residential Properties	89%	4%	5%	2%
All Long-Term Property Loans (Except Land)	46%	28%	16%	10%
All Construction Loans	80%	11%	6%	3%

Source: U.S. Department of Housing and Urban Development,
"Survey of Mortgage Lending Activity", January 1988.

Due to restrictions on bank participation in real estate brokerage activities, the principal interaction between banks and members of the real estate brokerage community has consisted of bank mortgage loan officers contacting real estate brokers and salespeople to solicit their business. Typically, a mortgage loan officer will visit several real estate offices each day to distribute rate sheets that quote current interest rates and terms available through their institution. Ultimately, the goal of a bank mortgage loan officer is to develop a long-term relationship with numerous real estate brokers and salespeople who will consistently recommend the loan officer to their homebuyers. Mortgage loan officers are usually compensated by receiving a portion of the loan origination fee paid by the borrower on loans they originate - typically 50 basis points (0.5 percent) of the face value of each loan.

In addition, banks may deal with the real estate brokerage community when they have taken back a property as a result of foreclosure. The services of a real estate broker may be of great value to a bank when a property needs to be sold quickly or needs maximum exposure through the local MLS system.

Banks also may deal with real estate brokerage firms as customers. Many state real estate commissions require that earnest money deposits be held by real estate brokers in federally insured accounts at banks or savings & loans in the state where the broker is licensed. Since earnest money deposits may comprise 5 percent or more of the purchase price

of a property, the escrow account of a large real estate brokerage firm could be a major account for a bank.

Real Estate Brokerage/Savings & Loan Affiliations

Although banks cannot own and operate real estate brokerage firms, it is interesting to note that savings & loan institutions are permitted to operate real estate companies. However, the majority of savings & loans that own and operate real estate brokerage firms do not have real estate agents located in their branches. Instead, most real estate brokerage firms affiliated with savings & loans take advantage of that relationship by distributing literature in their branches and by mailing literature in customer monthly statements.

An example of the real estate brokerage/savings & loan affiliation is Empire Savings of America, the Buffalo, New York-based savings & loan, which owns 99% of the Gallery of Homes franchisor operation. Empire Savings also operates a Gallery of Homes franchise in the Buffalo area, although it does not have real estate salespeople staffed in the savings & loan branches. Daniel Brown, Senior Executive Vice President of Empire Savings, believes that actually placing real estate salespeople in the savings & loan branches would not be of great value since the purchase and sale of real estate is not an impulse transaction.

In 1983, Great Western Savings of Beverly Hills, California, the nation's third largest savings & loan, purchased Walker & Lee, Inc., a California-based real estate brokerage firm, and changed the name to Great Western Real

Estate. Today, Great Western Real Estate, which is headquartered in Santa Ana, California, has 37 resale offices and approximately 1,700 agents. Based on 1986 data, Roulac [26] ranks Great Western Real Estate as the 22nd largest real estate brokerage firm in the United States, with gross revenues of \$59.1 million. Like the Empire Savings arrangement, Great Western Real Estate has no physical presence in the savings & loan branches. According to Robert Lind, Senior Vice President of Great Western Savings, management has been reluctant to allow real estate salespeople in the branches since they may be too "pushy" and offend the customers. Also, there is some concern over damaging existing relationships with real estate brokers and salespeople who currently refer mortgage loans to the savings & loan. Although they have not had salespeople in the branches, Mr. Lind mentioned that Great Western Savings has been able to capture approximately 40 percent of the loan business generated by Great Western Real Estate sales transactions.

Unlike Empire Savings and Great Western Savings, Twin City Federal Savings & Loan of Minneapolis, Minnesota, actually has a real estate brokerage office in five of their 46 branches. Twin City Federal purchased several Realty World franchises, and currently operates a real estate firm under the name "Realty World - TCF." Realty World - TCF has approximately 300 agents and ten offices, including the five offices in the savings & loan branches. Don Streeter, President of Realty World - TCF, states that the real estate brokerage operation

is generating \$40 to \$50 million annually in mortgage loan referrals to the savings & loan, and has achieved a 49 percent capture rate of loan business generated by Realty World - TCF agents. When asked what value he places on the presence of real estate offices in the savings & loan branches, Streeter said that most of the value is in terms of image and exposure. Based on over 30 years experience in the real estate business, Streeter's opinion is that the offices in the savings & loan branches do not generate any significant "walk-in" customers, and that the real estate agents in the savings & loan branches do the same amount of prospecting for listings and sales as agents who are not located in the savings & loan branches. Asked whether the real estate operation damages the savings & loan's relationships with local real estate brokers and salespeople, Streeter commented that although it is a sensitive situation, Realty World - TCF generates a significant enough portion of the savings & loan's mortgage originations that it counteracts the negative effects.

Another real estate firm with a savings & loan affiliation is Better Homes and Gardens Real Estate Service. The Better Homes and Gardens Real Estate Service, which is based in Des Moines, Iowa, currently has one franchisee in the State of Iowa that is a savings & loans institution, and according to Craig King, the National Marketing Director of Better Homes and Gardens Real Estate Service, a franchisee in the New York area will soon close a lease deal with a local bank to open real estate offices in 30 bank branches.

Guarantee Savings of Fresno, California, which was recently acquired by Glendale Federal Savings & Loan, currently owns and operates a three office 75 agent real estate brokerage firm called Guarantee Financial Realty in the Fresno area. However, the real estate brokerage offices and agents are not located in the savings & loan branches. A spokesperson at Guarantee Financial Realty said that a test marketing period of placing real estate agents in the branches did not prove successful since it did not generate enough referral business to make it worthwhile for an agent to be available at all times during normal business hours.

Undoubtedly, other real estate brokerage operations exist that are affiliated with savings & loans, and possibly with some state-chartered banks. This synopsis of real estate brokerage/savings & loan affiliations is by no means complete, and is intended only to give a brief overview of the current state of the industry.

Bank Regulation

There are four primary types of depository intermediaries in the United States: commercial banks, savings & loan associations, mutual savings banks, and credit unions. Each of these major categories can be subdivided in various ways, such as whether the institution is federally chartered or federally insured. This paper focuses on the category of state and federally chartered, federally insured, commercial banks as an alternative delivery system for real estate brokerage services.

According to the American Bankers Association, as of October 1987, there were 14,301 commercial banks in the United States. In general, these commercial banks are subject to a more complex system of supervision than any other type of institution. There are four principal categories of regulatory authority in the banking industry: (1) the 50 State Banking Departments, (2) the Federal Deposit Insurance Corporation, (3) the Federal Reserve Board, and (4) the Comptroller of the Currency. State Banking Departments or Commissions supervise state-chartered banks. The Federal Deposit Insurance Corporation (FDIC) is an independent agency of the federal government that insures deposits up to \$100,000 per depositor. The FDIC supervises FDIC-insured banks. The Federal Reserve Board and the 12 Federal Reserve Banks constitute the central bank of the United States. The Federal Reserve Board's chief responsibility is monetary policy, although the board also has broad supervisory and regulatory authority over the activities of member banks. In addition, the Federal Reserve Board regulates all bank holding companies. The Comptroller of the Currency's office is a bureau of the Treasury Department, designed to safeguard bank operations and the public through the regulation of national banks [10].

Banks are organized, or chartered, by either the state in which they plan to do business or by the federal government. For state-chartered banks, usually the State Banking Department or Banking Commission receives applications for bank charters, grants or denies applications, and supervises

and examines state-chartered banks in that state.

Banks chartered by the federal government are referred to as national banks. National banks are chartered, supervised, and examined by the Office of the Comptroller of the Currency. National banks, unlike state-chartered banks, are required to be members of the Federal Reserve System, and therefore must observe all applicable Federal Reserve regulations and are subject to supervision and examination by Federal Reserve authorities. In addition, national banks must have their deposits insured by the Federal Deposit Insurance Corporation. As a result, national banks are usually subject to higher minimum net capital requirements and higher reserve requirements than most state-chartered banks, and are more closely supervised and restricted in some aspects than state chartered banks.

While national banks are required to be members of the Federal Reserve System, state-chartered banks are not. State-chartered banks may become members if they desire, provided that they meet the requirements imposed by the Federal Reserve System. State-chartered banks that are members of the Federal Reserve System are subject to the same higher-reserve requirements and minimum net capital requirements as are national banks. They must also be members of the Federal Deposit Insurance Corporation, and are subject to examination by the State Banking Department, the Federal Reserve, and the FDIC.

Bank Restrictions on Real Estate Brokerage Activities

Under current interpretations of the law, national banks, bank holding companies, and most state-chartered banks are prohibited from owning and operating real estate brokerage firms. Although Congress is working on legislation which would address and possibly expand permissible bank activities, the most recent indications are that national banks and bank holding companies will continue to be prohibited from directly engaging in real estate brokerage.

While there is no language in federal regulations, and in state regulations that have been examined by the author of this paper, that explicitly states that real estate brokerage is not a permissible activity for banks, the regulators' interpretation of the law prohibits banks from engaging in real estate brokerage. For example, the Office of the Comptroller of the Currency's legal staff interpret the National Bank Act in such a way that national banks are prohibited from engaging in real estate brokerage. The Federal Reserve Board's interpretation of Federal Reserve Board Regulation Y (12 C.F.R., Section 225.25) prohibits bank holding companies and other banks under their regulatory jurisdiction from operating real estate brokerage firms. An example of state regulation, the State of Maryland's interpretation of the Annotated Code of Maryland, Financial Institutions, Section 3-206, prohibits state-chartered banks from owning and operating real estate brokerage firms. In each of these examples, the applicable regulations set forth a

"laundry list" of permissible bank activities, none of which includes real estate brokerage.

Although banks cannot directly own and operate real estate brokerage firms, federal and several state bank regulators have issued interpretive letters which would permit non-affiliated real estate brokerage firms to lease space in bank branches on a percentage-lease basis and to offer real estate brokerage services to the bank clients (see opinion letters in Appendix). Banks' authority to lease space on a percentage basis to real estate brokerage firms is conditional upon observance of several legal and prudential safeguards. First, banks cannot enter into a partnership with the brokerage firm. Second, banks should assure that the brokerage business is appropriately identified as a separate business so that the public will understand that it is not obtaining the brokerage services from the banks. Third, any bank advertising or literature that mentions the real estate brokerage firm should make clear that the firm is independently owned and operated. Fourth, the relationship between bank and brokerage firm must be at arms-length, and banks must avoid tying extensions of credit to the use of the brokerage services. Fifth, bank management should consider any security problems that may arise if the public is given access to the brokerage business during hours when banking services are not available. Sixth, banks should not lease space to bank employees, officers, directors, principal shareholders, or their immediate families for a brokerage operation due to conflicts of interest.

The most recent development in Congress with respect to banks and real estate brokerage involves both the NAR and the American Bankers Association (ABA). Late in June 1988, the NAR and ABA sent to Capitol Hill a carefully crafted agreement on banking legislation that would prohibit national banks and bank holding companies from directly engaging in real estate activities. The agreement is expected to be included in draft legislation offered to the House Banking Committee by its Chairman, Rep. Fernand J. St Germain, D-R.I., sometime in July 1988. The Banking Committee is expected to begin work on the bill in the middle of July, and a final measure could be voted on before the end of the summer, according to NAR analysts.

The NAR-ABA agreement specifies that, if freestanding national banks and bank holding companies are ever authorized to engage in real estate activities, those activities must be conducted through subsidiaries and must be governed by strict safeguards, or "firewalls," that would keep banking and real estate activities separate. The NAR-ABA agreement also stipulates the following: (1) Banks could lend to clients of the real estate affiliate only under similar terms to those available to other clients. (2) A bank affiliate would be prohibited from engaging in "tying" arrangements that require a customer of either the bank or the real estate affiliate to obtain any service, product, or property from an affiliated company. (3) The bank and the real estate affiliate would be prohibited from any joint advertising; cross marketing services, using the same or similar name, trademark, or logo;

sharing a common place of business; or sharing corporate and financial records. (4) A bank would be prohibited from exchanging non-public information about its customers with its real estate affiliate, except in connection with a bank loan to the affiliate, or when the information involves activities other than real estate activities. (5) A bank would be prohibited from using the services of its real estate affiliate, such as for disposing of the bank's inventory of foreclosed properties, except when the real estate services were provided on terms similar to those available to others.

One issue left unresolved in the joint NAR-ABA agreement is the application of the proposed safeguards to individuals with a simultaneous interest in a bank and a real estate brokerage firm. NAR analysts said that Rep. St Germain is interested in resolving this question, and a compromise probably will be reached in the final legislation.

CHAPTER FOUR: BANKS AS AN ALTERNATIVE DELIVERY SYSTEM FOR REAL ESTATE BROKERAGE SERVICES

Market for Real Estate Brokerage Services in Banks

In 1985 Dr. Kenneth Kehrer, an economist with Kenneth Kehrer & Associates in Princeton, New Jersey, examined the immediate and potential markets for offering real estate brokerage services in banks and thrift institutions [17]. His research was based on an analysis of the Survey of Consumer Finance, a large-scale household survey commissioned by the Federal Reserve Board, the Comptroller of the Currency, and other federal agencies. The Survey of Consumer Finance consisted of approximately 5,000 in-person interviews which were conducted by the Survey Research Center of the University of Michigan. The survey interview obtained detailed demographic and income data as well as comprehensive information on debts, assets, income, use of credit, and attitudes toward innovative financial services. In the opinion of Kehrer, at the time of his analysis, the Survey of Consumer Finance was unquestionably the best available data base to study consumer interest in real estate brokerage in banks and thrifts.

Kehrer's study concludes that the size of the market for real estate brokerage services in banks and thrifts is quite large. He estimates that 18.5 percent of U.S. households are interested in buying and selling real estate through a bank or savings & loan. Based on 1985 data, this constitutes a potential market of 14.7 million households. Kehrer estimates

that the immediate market for real estate brokerage services in banks and thrifts is 10 percent of U.S. households, or 7.8 million households based on 1985 figures.

Analyzing the potential market for real estate brokerage services in banks and thrifts by demographic characteristics, Kehrer concludes that the market for real estate brokerage services in banks and thrifts is not an upscale market. Of the potential households interested in transacting real estate business in banks and thrifts, 75 percent are in the middle and residual market segments (see Table 6 below for U.S. household segmentation). Nonetheless, half of these households

TABLE 6

U.S. Household Segments

Segment	Age of Head of Household	Annual Household Income	% of Total	Millions of Households
AFFLUENT	Under 55	\$70,000+	5%	2.0
MATURE	Over 55	All	16%	12.8
UPSCALE	22 to 55	\$20,000-\$70,000	14%	11.2
* MIDDLE	22 to 55	\$20,000-\$70,000	29%	23.2
RESIDUAL	----- All Others -----		36%	28.8

* Middle market households are similar in age and income to upscale households; however, in the middle market, the household head is not managerial or professional.

Source: "Consumer Attitudes toward Buying and Selling Real Estate through Banks and Thrifts", Kenneth Kehrer & Associates, 1985.

TABLE 7

Percent of Each Segment That Would Buy
Real Estate through Banks & Thrifts

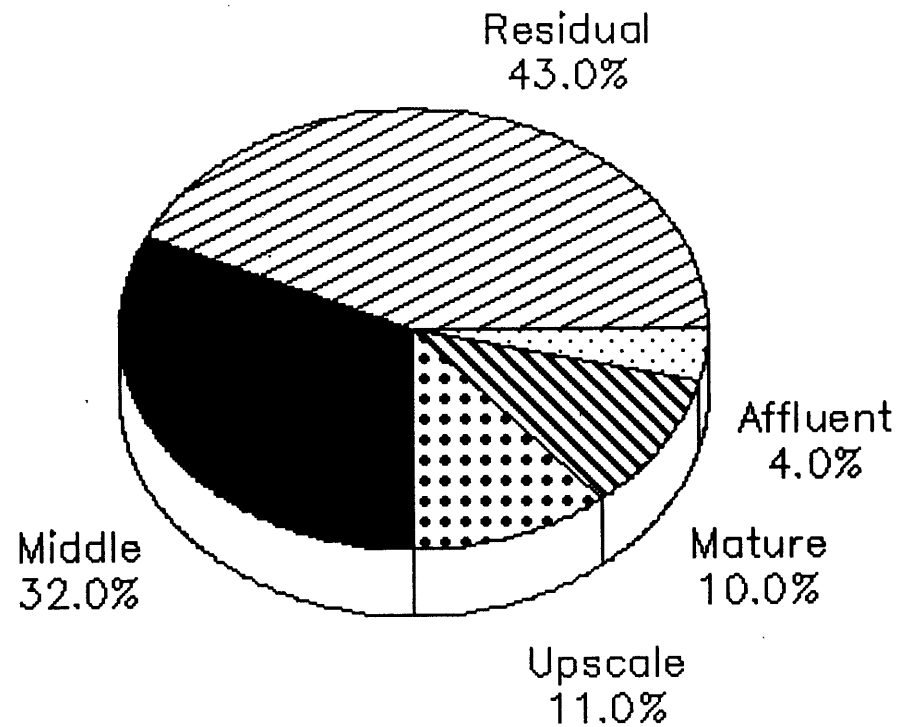
	Potential Market	Immediate Market	Rest of Potential Market
Affluent	15%	6%	10%
Mature	11%	5%	6%
Upscale	15%	6%	9%
Middle	20%	13%	8%
Residual	22%	11%	10%

Source: "Consumer Attitudes Toward Buying and Selling Real Estate Through Banks and Thrifts", Kenneth Kehrer & Associates, 1985.

own a home, and a substantial number own additional real estate. Of the affluent and upscale households, 15 percent are interested in buying and selling real estate through a bank or thrift, compared with 20 percent to 22 percent of middle and residual market households (see Table 7 above). Mature households are the least interested, with only 11 percent of respondents indicating that they would consider buying and selling real estate through banks and thrifts (see Figure 2 for a demographic breakdown of the potential market).

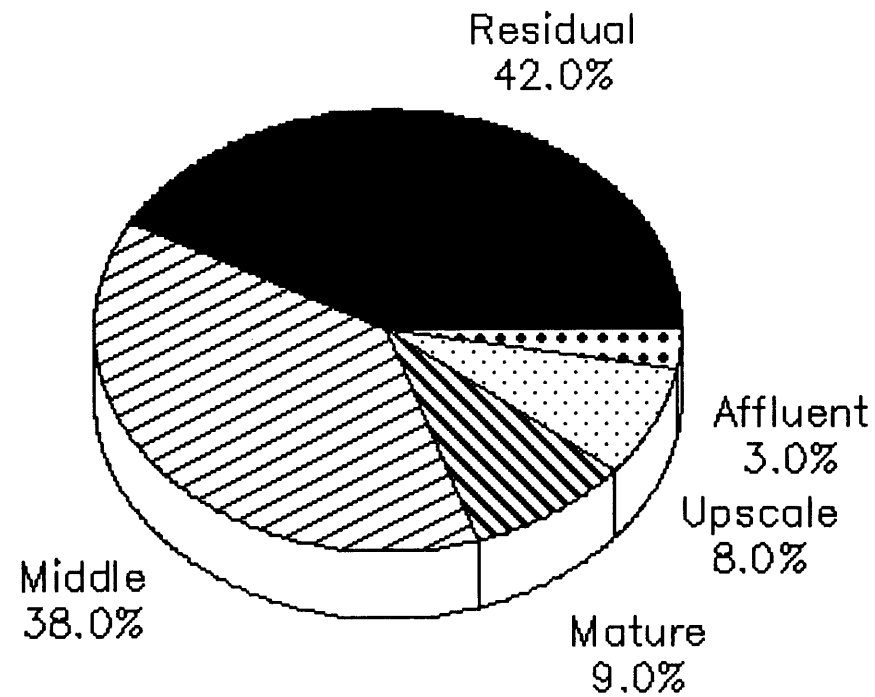
When Kehrer estimated the size of the immediate market for real estate brokerage services in banks and thrifts, he discovered that the downscale nature of the market is even more striking than in the estimated potential market. Between 11 percent and 13 percent of the residual and middle market

FIGURE 2: Potential Market
14.7 Million Households



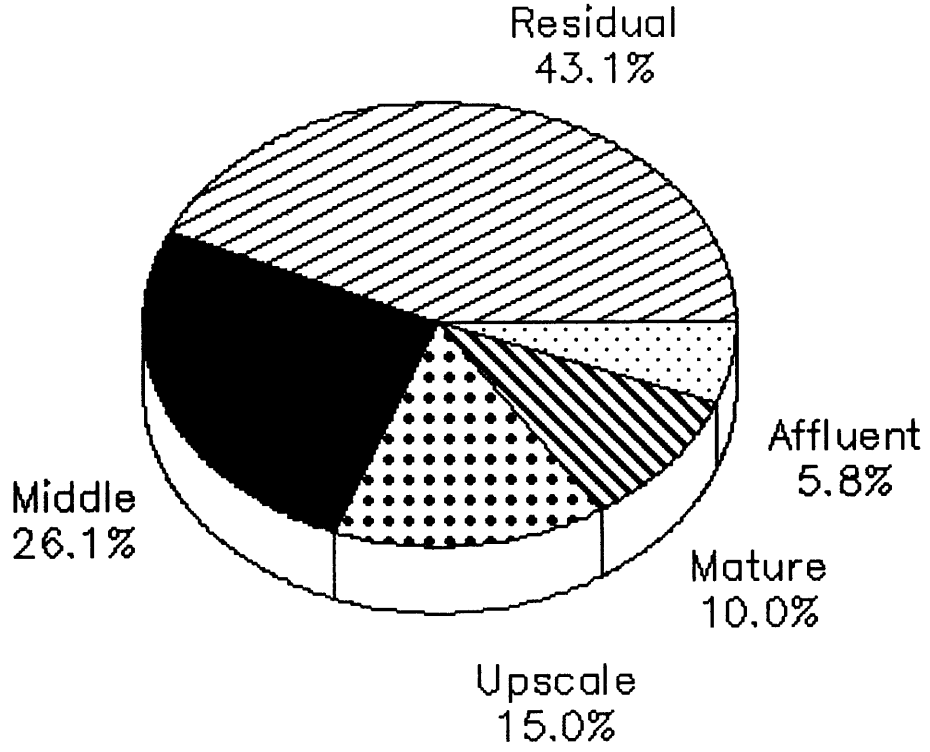
Source: Kenneth Kehrer & Associates [17]

FIGURE 3: Immediate Market 7.8 Million Households



Source: Kenneth Kehrer & Associates [17]

FIGURE 4: Rest of Potential Market
6.9 Million Households



Source: Kenneth Kehrer & Associates [17]

households are likely to take their real estate transactions into banks and thrifts in the short run, compared to 5 percent to 6 percent for the more upscale segments (see Figure 3 for a demographic breakdown of the immediate market).

The rest of the potential market households (excluding the immediate market households) are more upscale. A similar proportion (8 percent to 10 percent) of the affluent, upscale, middle and residual segments expressed interest in real estate brokerage services in banks (see Figure 4 for a demographic breakdown of the rest of the potential market).

In addition to looking at the demographic breakdown of the potential and immediate markets for real estate brokerage services in banks and thrifts, Kehrer examined consumer attitudes and opinions. He concludes that households in the potential market appear more committed than the general population to using innovative financial services. Also, households in the potential market are more likely to own equity in stocks and are more willing to take risks in their investments than the general population. Households in the potential market for real estate services in banks and thrifts are very interested in consolidating their financial business in one institution. This suggests that banks and thrifts not offering innovative financial services such as real estate brokerage may risk the loss of their customer base to other institutions already entering the business.

Finally, Kehrer pointed out that survey responses similar in nature to the Survey of Consumer Finance (which he used to

generate his conclusions) generally overestimate how many households would use services of this type. However, he believes that well-designed marketing campaigns and favorable experiences of others who buy and sell real estate through banks and thrifts could attract additional households to use such services.

While Kehrer's study does not differentiate between real estate brokerage services being provided directly by banks and savings & loans, or through contractual arrangements with non-affiliated real estate brokerage firms, for the purposes of this paper it is assumed that consumer attitudes and preferences would be the same in both cases.

Bank Market Survey

Ultimately, the success or failure of a real estate brokerage firm's efforts to develop a network of banks through which to offer brokerage services is contingent upon the willingness of bank management to embrace such a concept. In order to determine the willingness of bank management to consider offering real estate brokerage services, a survey of bank officers in Maryland, Virginia, and the District of Columbia was conducted by mail and by telephone. The 27 survey respondents consisted of bank presidents, CEOs, and marketing vice-presidents. Survey size was limited due to time constraints and a relatively low response rate (20 percent) to an initial mailing to bank management. Since banks in different parts of the country might have a higher or lower willingness to consider offering real estate brokerage

services, the survey was also limited by geographic sampling constraints.

The survey methodology consisted of the following: (1) providing the respondent with a brief explanation of the concept of offering real estate brokerage services in banks; (2) inquiring as to whether or not the respondent's bank would be interested in offering real estate brokerage services at some point in the future; (3) inquiring as to the perceived advantages, if any, of offering real estate brokerage services to the clients of the bank; and (4) inquiring as to the perceived disadvantages, if any, of offering real estate brokerage services to the clients of the bank.

Although limited survey size precludes meaningful statistical analysis, it is possible to make several broad generalizations about the willingness of bank management in the Washington, D.C. and Baltimore metropolitan areas to embrace this concept. For example, there is not an overwhelming or immediate interest in the banking community to offer real estate brokerage services, since only 2 out of 27 respondents (7.4 percent) indicated that their institution might have an interest in offering real estate brokerage. For the two respondents that indicated that their institution might have an interest in offering real estate brokerage services, the following three principal advantages were cited: (1) the real estate brokerage operation would generate additional revenue/fee income, (2) it would create an "in-house" source of mortgage loan originations, (3) real estate

brokerage would be a useful service to provide to customers.

Of the 25 respondents who indicated no interest in offering real estate brokerage services, two principal reasons or disadvantages were cited: (1) offering real estate brokerage does not conform to the strategic plan for the bank, and (2) offering real estate brokerage services may damage existing relationships with real estate brokers (i.e., real estate brokers who are currently referring mortgage loan business to the bank).

With several respondents, the subject of pricing of brokerage services and discount real estate brokerage were discussed. The general attitude seemed to be against offering real estate brokerage services at a discount, for fear of reprisals from the real estate brokerage community. In fact, one bank president believed that if real estate brokerage services were offered at a discount, someone would throw a bomb through his bank's windows.

Overall, the willingness of survey respondents to embrace the concept of offering real estate brokerage services was somewhat disappointing. However, banks may be more interested in offering real estate brokerage services than stock brokerage services. The "Invest" subsidiary of ISFA Corporation of Tampa, Florida is the largest provider of stock brokerage services in bank and savings & loan branches; with an estimated 75 percent of the market. According to David Butcher, Public Relations Director, Invest currently offers stock brokerage services through 270 out of an estimated

30,000 banks and savings & loans in the United States. Since the market leader has less than 1 percent market penetration among banks and savings & loans, it is conceivable that more banks may be interested in offering real estate brokerage than stock brokerage.

Advantages and Disadvantages

Clearly, for both the real estate brokerage firm and for the bank considering a contractual agreement to offer real estate brokerage services, advantages and disadvantages exist.

For the real estate brokerage firm, the largest advantage to offering real estate brokerage services in bank branches would probably be the increased visibility and market exposure, obtained with a relatively modest capital expenditure. By displaying posters and providing brochures in the branches, as well as mailing information in bank customers' monthly statements, the real estate brokerage firm would create the appearance of being active and having a physical presence in many different communities. Having a presence in many communities is significant since Richins, Black, and Sirmans [24] have shown that geographic dispersion (distance from real estate offices to listed homes) is a key variable in determining market share. For new real estate brokerage firms, or for smaller real estate brokerage firms with only a few offices, the market exposure to be gained by offering real estate brokerage services in bank branches might lead to significant increases in market share.

Another advantage for real estate brokerage firms offering

their services in bank branches is the possibility of direct-referral business. Upon receipt of information about real estate brokerage services being provided at their bank, the bank customers may contact the brokerage firm for information on buying or selling property. However, based on limited discussions with savings & loans that have offered real estate brokerage services, it appears that the amount of "walk-in" referral business generated by such operations is negligible.

Increased market exposure and the possibility of referral business generated through bank branches create an advantage for the real estate brokerage firm seeking to recruit new salespeople to join the firm. Colwell & Marshall [6] have demonstrated that the market share for listings and sales are greatest for firms having the largest number of salespeople.

Finally, real estate brokerage firms that offer their services through bank branches via a percentage lease arrangement would have the added advantage of transforming what for most firms is a fixed expense into a variable expense. That is, in a 1985 survey by the NAR [21], real estate brokerage firms spent an average of 12.4 percent of "company dollar" (gross income minus commissions to salespersons, franchise or referral fees, co-brokerage fees, and commissions paid to owners) on rent and utilities for their offices. In most cases, the rent for real estate brokerage firms is fixed, or is fixed with an added percentage rent. Real estate brokerage firms able to transform fixed expenses into variable expenses (i.e., by signing percentage

leases with banks), have a tremendous competitive advantage over firms with large fixed expenses. This is particularly important for real estate brokerage firms, since the real estate brokerage business is highly cyclical and is closely tied to market interest rates. During periods of high interest rates, real estate brokerage firms having good market exposure and low fixed expenses are in the best position to survive and gain market share from competitors.

There are several potential disadvantages for the real estate brokerage firm considering the possibility of offering real estate brokerage services in bank branches. First, the inordinate amount of time and work involved in locating a bank interested in offering real estate brokerage, presenting the concept to senior officers and the board of directors, and negotiating the details of the lease agreement, may be too much for the small real estate brokerage operator to consider. Using the analogy to stock brokerage being offered by the Invest network in bank and savings & loan branches, it may take six months or more to finalize an agreement with a bank to offer real estate brokerage services.

The downside to the real estate brokerage firm having a percentage lease arrangement with a bank is that during peak periods in the real estate cycle, when commission revenues are highest, the real estate brokerage firm will probably be paying a rent which is higher than that paid by its competitors. This risk could be offset to some extent by negotiating a percentage lease with a rental amount which

decreases with higher revenues, or by placing an overall cap on the amount of percentage rent to be paid.

Finally, in some cases the real estate brokerage firm would not benefit from the lease arrangement with a bank. In those instances where banks may not be fully committed to offering real estate brokerage services, the amount of exposure and referral business to be gained would not be worth the percentage rent paid to the banks. To guard against this possibility, the real estate brokerage operator would be wise to attempt to contractually segregate real estate brokerage business generated from banks from that generated from other sources. That is, although such separation of sources might be difficult, the real estate brokerage firm should pay percentage rent to banks only on that business generated through bank affiliations.

In order to close a percentage rent deal with a bank to offer real estate brokerage services, it is critical for the real estate broker to understand what motivates banks, and what advantages and the disadvantages banks will consider in the decision-making process.

As discussed previously in the "Bank Market Survey" section of this report, there are three principal advantages for banks offering real estate brokerage services. First, the bank would look to the real estate brokerage operation as a source for additional revenue/fee income. Historically, banks have made money principally by taking in deposits from customers at a stated interest rate and loaning the money back out at a

higher rate to borrowers. Today, banks earn significant revenues by offering and performing a variety of services for their customer bases. This trend toward "fee for service" revenue has led many institutions into offering new and unusual services to augment their interest income.

The second advantage to a bank offering real estate brokerage services would be the possibility of gaining a larger share of the market for originating and servicing residential mortgage loans. In a real estate sale transaction, the real estate agent generally exerts significant influence over the purchaser's selection of a mortgage lender. Of the savings & loans that have offered real estate brokerage, one has been able to achieve a "conversion rate" (the percentage of purchasers that end up getting their mortgage through them) as high as 49 percent. The revenue to be gained by banks originating and servicing home mortgage loans can be quite large. For example, institutions originating home mortgage loans typically earn at least one point (1 percent of the loan amount) up front as a loan origination fee. For a bank originating \$50 million annually in home mortgage loans, this would mean an extra \$500,000 in annual revenue from loan origination fees. According to Rob Rosenblatt, an economist with the Mortgage Bankers Association, the average annual servicing fee paid to the servicing agent for one-to-four family residential mortgage loans is between 40 and 44 basis points (.40 percent to .44 percent of the outstanding loan amount). Because mortgage loan servicing fees can create such

a substantial annuity over time, Rosenblatt stated that some institutions even originate loans at a loss in order to retain the servicing rights.

Finally, the third advantage to a bank offering real estate brokerage services is that it provides a useful service to bank customers. Offering real estate brokerage may help strengthen existing customer relationships or help establish new customer relationships. In addition, from a strategic standpoint, offering real estate brokerage services takes another step toward the vertical integration of financial services delivery - a recently evolving trend among larger financial institutions.

As noted earlier, there are several potential disadvantages to banks offering real estate brokerage services. Other than real estate brokerage not being part of the bank's strategic plan, the biggest disadvantage perceived by bank management is the possibility of damaging existing relationships with real estate brokers. If a bank currently derives a large amount of revenue from mortgage loan originations through the real estate brokerage community, then the potential exists for decreased revenue as a result of offering real estate brokerage. Any short-term decrease in loan origination revenue, however, may be more than offset by a longer-term increase in revenue due to loan referral business from the real estate brokerage operation. If on the other hand, a bank does not originate most of its mortgage loans through real estate brokers, or the amount of their home mortgage loan originations is currently insignificant, then offering real

estate brokerage services could result in a direct increase in revenue from the outset.

Another disadvantage for banks considering offering real estate brokerage services is the possibility of alienating existing customers. If the real estate salespeople become too aggressive, or if a customer has a bad experience using the brokerage services, they may take their banking business elsewhere.

Summary of Proposed Delivery System

While it is impossible, without extensive field research and testing, to definitively determine the optimal methodology for delivering real estate brokerage services in bank branches, it is possible to develop a theoretically optimal delivery system based on the limited research in the field. This section describes such an optimal approach for maximizing market share and profits in the delivery of real estate brokerage services in bank branches, by analyzing the following issues: (1) contractual and legal considerations, (2) marketing strategies and pricing of brokerage services, and (3) hiring and motivating real estate salespeople.

As noted earlier, most banks are currently prohibited from owning and operating real estate brokerage firms. This prohibition would preclude banks from purchasing, acquiring, or holding an equity interest in a real estate brokerage firm. In addition, in most states real estate brokerage firms are prohibited from paying "finder's fees" or referral fees to individuals or companies that refer potential clients, unless

the entity making the referral holds a valid real estate license. Therefore, in order to legally offer real estate brokerage services to their customers and still receive some form of compensation, banks must execute lease agreements with non-affiliated real estate brokerage entities to provide such services (see bank regulator opinion letters in Appendix).

For example, a real estate brokerage firm may execute a lease to permit the brokerage firm to occupy a 100 square foot area in each branch office of the bank. The rent payable to the bank under the lease may be fixed amount, a fixed or variable percentage of revenue, or some combination thereof. In terms of an optimal arrangement for the real estate brokerage firm considering offering brokerage services in banks, the best lease agreement would be one in which the rent is calculated on a percentage basis with no fixed obligation, or a very small fixed obligation, with the additional benefit of a cap on the maximum rent that would be paid in a given time period. This would give the real estate brokerage firm a competitive advantage during both slow and peak periods in the real estate market. During slow periods in the real estate cycle, the brokerage firm would incur no large fixed rent expenses, and during peak periods in the real estate cycle, the rent expenses would not become unusually large. However, one potential obstacle for a bank considering leasing space to a real estate brokerage firm would be legal provisions in the bank's branch office lease(s) that may prohibit the bank from subleasing space or from utilizing their branch office space

for certain activities (i.e., real estate brokerage).

In addition to specific lease considerations for real estate brokerage firms, as discussed earlier, banks must adhere to other guidelines established by the regulatory authorities in order to legally offer real estate brokerage services. First, the bank cannot enter into a partnership with the real estate brokerage firm. This issue can be overcome by carefully drafting a percentage lease agreement.

Second, banks must assure that the brokerage business is appropriately identified as a separate business so that the customers will understand that they are not obtaining the brokerage service from the bank. Also, any bank advertising or literature that mentions the real estate brokerage firm must make clear that the firm is independently owned and operated. The use of disclosure language on brochures, advertising, and signs should address these issues. In addition, the real estate brokerage operation could be given the appearance of separation from the bank business through the use of different colored carpeting on the floor, movable partitions, or a kiosk-type booth.

The third guideline that must be adhered to is that the relationship between the banks and the brokerage firm must remain at arms-length, and banks must avoid tying extensions of credit to the use of the brokerage services.

Fourth, bank management must consider any security problems that may arise if the public has access to the brokerage business during hours when banking services are not available.

This issue can be avoided by the real estate brokerage firm utilizing the bank branches only during normal banking hours.

Finally, banks cannot lease space to bank employees, officers, directors, principal shareholders, or their immediate families for a real estate brokerage operation, due to conflicts of interest.

Developing an optimal marketing strategy and optimal pricing strategy for offering real estate brokerage services in bank branches are difficult issues to definitively resolve.

In terms of a marketing strategy, prior research by Richins, Black and Sirmans [24] indicates that real estate brokerage firms should locate their offices near areas in which they would like to sell property, and that the more properties a firm has sold in an area, the greater the probability of making subsequent sales in that area. This research suggests that the "shotgun approach" to real estate brokerage should be avoided. Instead, the real estate brokerage firm should attempt to be geographically specific with respect to its principal area of service. The size of the geographic area should vary in accordance with the number of offices, the size of the sales staff, and the financial resources of the firm. This concept is widely acknowledged and adhered to in the real estate business and is frequently referred to as "farming" a territory or region. In the context of offering real estate brokerage services in bank branches, it may be difficult to get highly specific with respect to geographic region of service since some banks have multiple

branch locations which can be widely dispersed. Accordingly, a new real estate brokerage firm, or a brokerage firm with limited resources, should attempt to lease space in branches of banks which are in reasonably close proximity to their office(s) and which tend to service the same community(ies). Larger brokerage firms, or those with significant resources to devote to developing new sales areas, might consider leasing space in bank branches outside of their normal area of operation.

From an operations standpoint, it is also beneficial for the real estate brokerage firm to keep all of the leased bank branches within close proximity to an existing real estate office. In order to comply with regulatory restrictions, the bank leased space would not be available to real estate salespeople after normal banking hours. Therefore, since it is essential that real estate salespeople have 24-hour, 7-day-a-week access to copying equipment, telephones, contract forms, conference rooms, and the MLS computer system, the real estate brokerage firm should maintain a fully equipped office reasonably close to the leased bank space.

In actuality, the leased bank branch space would seldom be occupied by a real estate salesperson. The historical experience of savings & loans that have operated real estate brokerage firms seems to indicate that the walk-in referral business generated by having a salesperson available at all times in the branches is insufficient to motivate a commission only salesperson to consistently staff the branches. Instead,

the lease relationship with the bank should be used primarily to increase the market exposure, image, and credibility of the real estate brokerage firm, as well as to potentially generate direct referral business.

Research by Richins, Black, and Sirmans [24] demonstrates that it is easier for a brokerage firm to sell less-expensive properties (relative to the average value of properties sold by the firm) than more expensive properties. That is, it is easier for a real estate brokerage firm to go down-market than up-market. Kehrer [17] indicates that the market for real estate brokerage services in banks and savings & loans is not an upscale market, so the real estate brokerage firm contemplating offering brokerage in bank branches should expect that the majority of the referral business generated directly from the bank lease arrangement would be for the purchase or sale of lower-priced homes. Consequently, to capture a larger share of the market for higher-priced homes in a given region, the real estate brokerage firm should concentrate its marketing efforts outside of the bank lease arrangements on selling and listing homes priced above the median.

Regarding strategic orientation, Richins, Black, and Sirmans [24] believe that real estate firms follow one of three strategic orientations with respect to revenue generation: a balanced strategy (equal weight to selling and listing), an autonomous strategy (little dependence on other firms), or a selling strategy (emphasizing selling over

listing). Their research indicates that firms following a balanced strategy achieve higher relative measures of market performance, both in terms of absolute number of sales and listings, and in number of sales and listings per agent. Therefore, for the real estate brokerage firm offering its services in bank branches, the balanced strategy is probably best. Using the balanced strategy, the brokerage firm would have a good chance of earning commissions on listings and sales from bank-affiliated referrals, and by getting listings, would have an adequate internal inventory of properties to advertise. In turn, having properties to advertise for sale attracts additional buyers to the firm, some of whom may have properties to sell. Of the largest real estate brokerage firms in the United States, as surveyed by Roulac [26], all but a few firms seem to pursue a balanced strategy as evidenced by the balanced breakdown of business composition between listing and sale, sale only, and listing only.

An autonomous strategy is difficult to successfully implement, since most major metropolitan areas (like the Washington, D.C. area) have well-established MLS systems in which virtually all major residential real estate brokerage firms participate. Even large independent real estate brokerage firms in this type of environment have difficulty surviving without the benefit of the MLS system. Since most MLS systems require members to input all listings, or nearly all listings, it is usually not feasible to operate under an autonomous strategy on a large scale.

Like the autonomous strategy, a selling strategy is also difficult to implement successfully on a large scale. In most cases, in order to attract potential purchasers a real estate brokerage firm must have listings to advertise. Generic advertisements that read "homes for sale" or "we sell houses," without making reference to a specific property, usually do not motivate prospective purchasers to call a real estate brokerage firm (although there is no research to prove this conclusion). Therefore, unless a brokerage firm has a large, steady source of potential purchasers, a selling strategy should be avoided.

For the real estate brokerage firm considering a lease arrangement with a bank, there are several ways to make bank customers aware of the availability of real estate brokerage services. First, brochures or literature describing the real estate brokerage services can be sent to the bank customers in their monthly statements. Second, in each branch of the bank the real estate brokerage firm can display brochures, posters, countertop placards, and photographs of homes currently for sale. Third, since many banks now use their automated teller machines as advertising media, the real estate brokerage firm can make arrangements with the bank to have a brief message appear on the automated teller screens.

Closely related to the selection of an appropriate marketing strategy for real estate brokerage is the selection of an optimal pricing strategy. Selection of an optimal pricing strategy is very difficult, if not impossible, due to

the fact that the real estate brokerage industry has had limited experience with price competition. However, in the context of offering real estate brokerage in bank branches, offering real estate brokerage services at a discount may be detrimental to the real estate brokerage firm. Since cooperation among brokers is critical to the success of a real estate firm, offering services at a discount can lead to a lack of cooperation from traditional real estate brokers, as is shown in a 1983 Federal Trade Commission report [27]. In addition, the FTC report cites numerous examples of discount brokers being harrassed by traditional real estate brokers. Incidents such as death threats, damage to property, and disparagement are commonly reported among discount brokers. Consequently, because of historical problems with discount real estate brokerage, it is unlikely that most banks would want to become involved in such a controversial business. In addition, banks that currently originate a significant number of home mortgage loans through real estate brokers would most certainly see their referral business from outside brokerage firms drop dramatically if they began to offer discount brokerage. Therefore, although traditional economic theory suggests that offering real estate brokerage services at a discount would be the best way to gain market share, offering real estate brokerage services at traditional pricing levels seems to be the best approach for the brokerage firm considering bank lease arrangements.

The ability to hire and motivate good real estate

salespeople is probably the most critical factor in determining the success or failure of a real estate brokerage firm. In fact, research by Colwell and Marshall [6] demonstrated that the most consistent factor in determining the market share per salesperson of listings and sales was the number of salespeople licensed with the brokerage firm.

Research in the field of real estate brokerage indicates that the brokerage firm should attempt to hire experienced salespeople who are capable of working in excess of 50 hours per week. In addition, it is advantageous to hire salespeople experienced in listing and selling higher-priced homes, since they have a higher probability of being able to list and sell homes in the moderate and lower-price ranges. However, there might be some resistance from agents that sell upper-bracket homes to dealing with moderate income buyers and sellers.

Traditionally, real estate brokerage firms have attracted good salespeople based upon their reputation for service, their physical location and facilities, the size of the firm, the amount of market exposure and name recognition of the firm, the variety of services the firm offers, and the "payout" or percentage of the total commission that the firm is willing to pay to the salesperson. The payout to a real estate salesperson is a very important factor, since real estate salespeople usually do not receive any base salary and are compensated solely on the basis of commission income.

Over the past 15 years, the issue of commission payout has been used successfully to build one of the nation's largest

real estate brokerage firms, RE/MAX International. Founded in 1973 by two real estate entrepreneurs, Dave and Gail Liniger, RE/MAX International is based on the concept of offering experienced, full-time real estate salespeople 100 percent payout of the commissions they earn. In 1986 RE/MAX had already become the third largest real estate brokerage firm in the United States with \$815.9 million in gross revenues and 11,923 salespeople [26]. RE/MAX sells franchises to local real estate brokers who operate real estate brokerage offices in assigned territories. The local brokers attract top real estate salespeople by offering 100 percent payout of commissions to salespeople who agree to pay a fixed monthly fee to the broker to cover basic office expenses and the broker's profit. The phenomenal growth of RE/MAX, which has been in excess of 40 percent per year since its inception, supports the belief that good salespeople are highly sensitive to the percentage payout of commission income.

Consequently, new or existing real estate brokerage firms contemplating offering their services in bank branches should consider the possibility of attracting top real estate salespeople with a 100 percent commission payout option. However, for sales leads and listing leads which originate as a result of the bank lease arrangement, the real estate salesperson receiving 100 percent payout would have funds subtracted from gross commissions (sufficient to pay the applicable amount of percentage lease payment to the bank). Real estate brokerage firms should also consider that bank

lease arrangements themselves may attract good real estate salespeople to join the firm. Since research has shown that the more real estate salespeople a firm has, the higher the market share per salesperson, it appears that brokerage firms should attempt to hire as many salespeople as possible.

CHAPTER FIVE: SUMMARY AND CONCLUSIONS

The real estate brokerage industry in the United States comprises approximately 15,000 active real estate brokerage firms, and generated an estimated commission revenue in 1986 of \$30 billion. Of the \$30 billion in 1986 commission revenue, approximately 83% was generated from residential real estate transactions. Although most of the brokerage firms tend to be small-scale companies with less than ten salespeople, the larger real estate brokerage firms have expanded their operations through vertical integration. Today, many real estate brokerage firms provide mortgage loan origination services, title searches, appraisals, insurance, and settlement services.

While some financial service providers such as savings & loans have been able to vertically integrate by offering real estate brokerage services, most banks have been prevented by law from owning and operating real estate brokerage firms. However, banks are permitted to offer real estate brokerage services to their client base through a percentage lease arrangement with a non-affiliated real estate brokerage firm.

This paper has examined the residential real estate brokerage industry in the United States and has analyzed the feasibility, advantages, and disadvantages of a new or existing real estate brokerage firm offering its services through commercial banks via a percentage lease or similar contractual arrangement. The analysis indicates that it is legally permissible for banks to offer real estate brokerage

services to their clients via a lease arrangement, provided that banks adhere to certain guidelines established by the regulators.

For the real estate brokerage firm considering offering its services through banks via a lease arrangement, the principal advantages appear to be increased market visibility, enhanced image, and increased credibility. Experiences of savings & loans which have offered real estate brokerage indicate that the amount of walk-in referral business from a real estate brokerage operation located in branches is negligible.

Banks can benefit from the lease arrangement by receiving rental income from the brokerage firm, as well as potentially increasing their volume of home mortgage loan originations. However, the principal drawback, as seen from the perspective of the banks surveyed, is that offering real estate brokerage services may damage their relationships with real estate brokerage firms which currently refer mortgage loan business. In a survey, only 2 of 27 (7.4 percent) bank officials stated that they may be interested in offering real estate brokerage.

Given an estimate of the potential market for real estate brokerage services in banks and savings & loans of 18.5 percent of U.S. households (14.7 million households based on 1985 data), it appears that the concept of offering real estate brokerage services in bank branches is not only feasible but also potentially profitable. The new or existing real estate brokerage firm should certainly explore the concept of offering brokerage services in bank branches as a means of increasing both market share and profits.

APPENDIX:

OPINION LETTERS FROM BANK REGULATORS



Comptroller of the Currency
Administrator of National Banks

Washington, D. C. 20219

November 17, 1987

Larry E. Hinman, President
Developers Capital Corporation
8 Old Baltimore Court
Olney, Maryland 20832

Dear Mr. Hinman:

This is in response to your letter dated July 28, 1987, proposing that your company, Developers Capital Corporation ("Corporation"), lease space in the branch offices of national banks to offer the Corporation's residential and commercial real estate brokerage and consulting services. In some cases, rent would be paid on the basis of a percentage of the revenue generated from the Corporation's business in the leased space. Based on the facts and conditions described below, I have no objection to your proposal.

Summary of Proposal

The Corporation, as mentioned, would lease space on a percentage basis from national banks to offer the Corporation's real estate consulting and brokerage services. The Corporation proposes that its real estate brokerage services be made available to the banks as well as the public. Thus, a bank would have the option of disposing of real estate acquired through foreclosure and the like by using the Corporation's brokerage services.

Your proposal is accompanied by representations that the following conditions would apply. First, none of the lessor banks or their officers, directors, employees or affiliates would hold any stock in the Corporation. Second, the described relationships between the banks and the Corporation would be at arms-length, and there would be no arrangements tying a bank's extension of credit to a customer's acceptance of a product or

service from the Corporation. Third, the real estate brokerage activities of the Corporation would be appropriately identified as being separate from the banks' business.

You also indicate that there would be no relationships between the banks and the Corporation other than those described. I have therefore assumed that the Corporation would not employ bank personnel to provide or manage the provision of the Corporation's products and services.

Finally, you represent that the Corporation's activities would be conducted in full compliance with applicable state law, including the regulations promulgated by the various state real estate commissions.

Discussion

Permissibility of Proposed Bank Activities

It is well established that national banks may lease their excess office space to others pursuant to 12 U.S.C. §§29 and 24(Seventh). See Wirtz v. First National Bank & Trust Co., 365 F.2d 641, 644 (10th Cir. 1966); Wingert v. First National Bank, 175 F. 739, 741 (4th Cir. 1909), appeal dismissed 223 U.S. 670 (1912); Brown v. Schleier, 118 F. 981, 984 (8th Cir. 1902), aff'd 194 U.S. 18 (1904). Incidental to a national bank's power to lease its office space is the authority to establish appropriate lease terms by bargaining for whatever terms are usual and customary in the leasing of commercial office space. See Interpretive Letter 274 from Brian Smith, Chief Counsel (Dec. 2, 1983), reprinted in Fed. Banking L. Rep (CCH) ¶85,438. As a result, the Office found in Interpretive Letter 274 that a national bank may lease excess space in its lobby to an insurance agent, and receive rent in the form of a percentage of the insurance agent's volume of sales or gross income from the rented lobby space. See id.

Because national banks merely exercise their leasing authority rather than engage in the business of a given tenant by leasing excess space on a percentage basis, Interpretive Letter 274 established that banks' authority to enter into percentage leases applies regardless of the nature of the tenant's business. 1/ Accord Letter from Peter Liebesman, Assistant

1/ Since the lessee described by Interpretive Letter 274 was not a bank employee and did not propose to employ bank employees to sell the lessee's products and services, the Interpretive Letter did not address the circumstances under which a national bank could share its employees with a party renting lobby space on a percentage basis. Similarly, I need not address this matter here since you have not proposed that the Corporation employ bank personnel.

Director, Legal Advisory Services Division (Nov. 20, 1984) (LASD Precedent File No. 42 for 12 U.S.C. §24(Seventh)). Therefore, national banks may lease excess office space to real estate brokers and consultants, such as the Corporation, on a percentage basis pursuant to 12 U.S.C. §§24(Seventh) and 29.

Banks' authority to lease on a percentage basis is conditioned on their observance of the legal and prudential safeguards enumerated by Interpretive Letter 274, which will be summarized here. First, banks cannot enter into a partnership with the tenant.^{2/} State law generally negates any inference of a partnership from percentage leasing; however, such an inference could arise in cases where the lease percentage is unusually high or the lessor exercises management control over the lessee. See Uniform Partnership Act § 7(4)(b); Friedman on Leases § 6.101 (2d ed. 1983). Banks and their counsel should accordingly review the lease terms under state law to ensure that no partnership would be created. In addition, Interpretive Letter 274 advises lessor banks to include a lease clause expressly precluding the existence of a partnership, and for safety and soundness reasons, a lease clause expressly precluding any bank liability for a tenant's debts and other liabilities. See Interpretive Letter 274, supra.

Second, banks should assure that the tenants' business is appropriately identified as a separate business through the use of signs, labeling, and the like so that the public will understand it is not obtaining the tenant's products and services from the banks. See id.

Third, any bank advertising or literature that mentions the tenant should make clear that the tenant's business is independently owned and operated. See id.

Fourth, the relationships between banks and a tenant must be at arms-length, and banks must avoid arrangements tying extensions of credit to the sale of the tenant's products and services. See id.

Fifth, bank management should consider any security problems that may arise if the public is given access to the tenants' business during hours when banking services are not available. See id.

Sixth, Interpretive Letter 274 advised against leasing retail banking or lobby space to bank employees, officers, directors, principal shareholders, or their immediate families for the operation of their businesses due to the conflict of interest, self-dealing, and tying questions that leases to insider-owned businesses could raise. See id.

^{2/} Banks are generally prohibited by 12 U.S.C. §24(Seventh) from entering general partnerships. See Merchants National Bank v. Wehrmann, 202 U.S. 295 (1906).

Your proposal to lease space from national banks is accompanied by representations that comport with the second, fourth, and fifth conditions described above. Therefore, banks must also adhere to the remaining conditions above to satisfy the legal and prudential concerns described in Interpretive Letter 274.

Finally, the limitations of Interpretive Letter 274 do not generally preclude a bank from having access to the services offered by its tenant to the public. In my opinion, such non-leasing transactions between a bank and its tenant do not give cause for objection where the bank is authorized to engage in the transactions and the transactions are conducted on an arms-length basis. In this case, the Corporation would make its real estate brokerage services available to banks as well as the public, and therefore give banks the option of purchasing and selling real estate through the Corporation. Under 12 U.S.C. §29, national banks are expressly authorized to purchase and convey real estate for the purposes described by the statute. Thus, banks' use of the Corporation's brokerage services to purchase and convey real estate for the purposes authorized by 12 U.S.C. §29 would not give cause for objection if done on an arms-length basis. You represent in your letter that all transactions between banks and the Corporation would be at arms-length. As a result, I assume that any brokerage transactions would be at arms-length, and in particular, that banks would not be obligated in any manner to use the Corporation's brokerage services.

Applicability of Real Estate Moratorium of CEBA § 201(b)(6)

Section 201(b)(6) of the Competitive Equality Banking Act of 1987 ("CEBA") precludes the Office from issuing a rule, regulation, or order that would have the effect of increasing the real estate powers of banks. This letter does not have the effect of increasing banks' real estate powers since the letter addresses an existing real estate power: the power of banks to lease their excess office space pursuant to 12 U.S.C. §§24(Seventh) and 29. The subject bank power was recognized by the courts and specifically applied to percentage leases by Interpretive Letter 274 prior to the moratorium period. Similarly, this letter's discussion of banks' use of real estate brokerage services also addresses an existing real estate power--the express power of banks to purchase and convey real estate for the purposes authorized by 12 U.S.C. §29--and consequently, does not have the effect of increasing banks' real estate powers. Therefore, the real estate moratorium of CEBA section 201(b)(6) could not apply here.

Conclusion

In my opinion, your proposal does not give cause for objection if implemented in accordance with the facts and conditions described here.

Sincerely,

Jonathan Rushdoony
Senior Attorney
Legal Advisory Services Division

cc: William Glidden, Assistant Director, LASD

May 22, 1987

Mr. Larry E. Hinman
President
Developers Capital Corporation
8 Old Baltimore Court
Olney, Maryland 20832

Dear Mr. Hinman

By letter of May 12, 1987, you requested the FDIC's opinion on whether or not a particular program Developers Capital Corporation ("Developers") intends to enter into with FDIC state chartered insured nonmember banks complies with any applicable federal statutes and regulations. According to your letter, Developers offers general real estate brokerage and consulting services. Developers proposes to enter into arrangements with state chartered insured nonmember banks whereby it will rent space in bank branches which would be used to offer residential and commercial real estate brokerage services to bank customers. The lease terms may be calculated as a percentage of revenue generated from the brokerage services during the previous month. The banks involved may promote Developers' brokerage services by distributing literature to their customers or by placing signs or posters in branch offices. Neither the banks, their officers, nor their directors will have any equity interest in Developers but the banks may from time to time utilize Developers' services to liquidate portfolio properties or DPC property.

Please be advised that the FDIC's current regulations do not prohibit an insured nonmember bank from leasing space in its branch offices to a real estate brokerage firm. Whether or not a bank may do so is therefore dependent upon state law. The FDIC would, of course, at a minimum, evaluate such leasing arrangements for conformance with safe and sound banking practices. Each situation would be evaluated on the basis of the particular facts and in view of applicable laws and regulations of the state in which the bank is located. Generally speaking, the utilization of bank space, equipment and personnel in connection with the operation of any business which is not an intergral part of the bank would require reimbursement to the bank. Full details regarding the lease arrangement should be disclosed to the bank's shareholders and of course be approved by the bank's board of directors.

What constitutes adequate compensation will vary from circumstance to circumstance. The FDIC would be concerned that customers of the brokerage agency that leases space in a bank's branch office are fully apprised that they are dealing with a separate and completely independent entity from the bank. More over, as the relationship is one which is fraught with possible conflicts of interest, the arrangement would probably be the subject of careful review during an examination of the bank.

We hope that the above is responsive to your request.

Sincerely,

✓
Pamela E.F. LeCren
Senior Attorney

STATE OF MARYLAND

WILLIAM DONALD SCHAEFER
Governor

WILLIAM A. FOGLE, JR.
Secretary

MARGIE H. MULLER
Bank Commissioner



Department of Licensing and Regulation
STATE BANK COMMISSIONER

THE BROKERAGE — SUITE 800
34 MARKET PLACE
BALTIMORE, MARYLAND 21202-4076
301/333-6262

May 22, 1987

Mr. Larry E. Hinman, President
Developers Capital Corporation
8 Old Baltimore Court
Olney, Maryland 20832

Dear Mr. Hinman:

This is in response to your letter to me dated May 12, 1987. In your letter, you request an opinion that your company, Developers Capital Corporation ("DCC"), may lease space in banks located in the State of Maryland. For the reasons stated herein, and also upon the terms and restrictions stated herein, it is my opinion that this activity is permissible under Maryland law.

As I understand the facts, DCC is a general real estate brokerage firm. DCC would lease space in branch offices of banks and offer residential and commercial real estate brokerage services with the customers of the bank. The rent paid would be a percentage of revenue generated from the services. The banks may assist DCC by distributing literature to their client base or by placings signs or posters in the branches. The banks, their officers, directors, or other affiliates will not have an equity interest in DCC. DCC may be retained by a bank in regard to that bank's real estate held as a result of foreclosures. These transactions constitute the full relationship of DCC with the banks.

There are no specific provisions in Maryland law that concern the leasing of space by a bank to a real estate brokerage concern. However, I may approve activities for Maryland banks that are permissible for national banking associations pursuant to Maryland Financial Institutions Article, §5-504(a). National banks have been permitted to lease space in their offices and branches to both insurance agents and travel agencies under percentage leases. See OCC Interpretative Letter No. 274, Fed. Banking L. Rep. (CCH) ¶85,438; and OCC Interpretative Letter No. 342, Fed. Banking L. Rep. (CCH) ¶85,512. See also Wirtz v. First National Bank & Trust Co., 365 F.2d 641, (10th Cir. 1966) The rationale is that it is incidental to bank business

Mr. Larry E. Hinman
May 22, 1987
Page 2

for a bank to own its premises and lease space therein. That rationale is applicable here subject to the restrictions set out below.

National banks are permitted to lease space in bank buildings with certain restrictions. These restrictions are that:

- (1) The non-banking business should be appropriately and separately identified from the banking business;
- (2) The relationship between the bank and the leasing entity should be arm's length and the bank must insure that there are no tying arrangements;
- (3) The bank should consider security problems if the tenant requires after-banking hours entrance either by customers or employees; and
- (4) The bank should avoid leasing any space to employees, directors, or officers of the bank or entities controlled by such people.

Since these requirements have been imposed upon national banks, it is my opinion that these restrictions are also applicable to state-chartered banks. Consequently, it is my opinion that the activity as you propose is permissible for state-chartered banks subject to the above restrictions. If you have any questions, please call Assistant Attorney General Frank C. Bonaventure, Jr., Chief of Financial Regulations and Advice, at (301) 333-4214.

Sincerely,

✓
Margie H. Muller
Bank Commissioner

MHM:pjp

cc: Frank C. Bonaventure

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