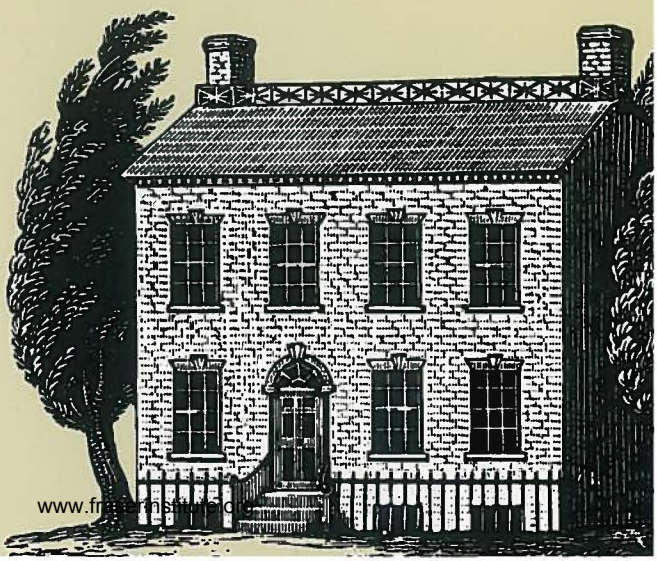
Home, Sweet Home

Real Estate Brokerage in Canada

Alexander W. Jenkins



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PREFACE

Real estate brokerage is primarily a consumer service, and yet most of us will deal with a real estate agent only a few times during our lifetimes. Even though homeowners are moving two or three times as often in the 1980s as they did during the 1960s and 1970s, only about 5 percent change residence in any particular year. Partly because of our inexperience, most of us choose to employ the services of real estate agents in buying and selling our properties. When we sell, we typically remit a widely adopted "formula" commission: 6 percent in eastern Canada, and, in western Canada, 7 percent plus 3 percent on any house value in excess of $100,000. Since these outlays are substantial, all of us, as homeowners, agents, policy makers and advisers, and researchers, might benefit from the better understanding of real estate brokerage that is purposed by this study.

Because homeowners change residences so infrequently, they are often unfamiliar with property appraisal, advertising, negotiating, and other dimensions of property resale and transfer. As a result, roughly 90 percent engage a real estate agent, and of these, about four out of five transact through the Multiple Listing Service, or MLS, particularly in slower markets. In return, home sellers receive a higher gross price (by roughly 3 percent), but a lower net price (by about 3 percent); buyers receive a better "match"; and both reduce personal time, psychic, out-of-pocket, and other search and transactions costs. To the extent that the real estate brokerage market is genuinely competitive, society as a whole realizes a large welfare surplus from the resulting efficient resale housing market.

The output and employment of real estate brokerage have grown more than twice as fast as the rest of the economy during the past two decades. Increasing rates of property turnover are the main explanation for this growth. These are in turn the consequences of greater geographic mobility, partly due to company and state moving subsidies; upward filtration from starter to executive homes by baby-boomers during an era of high housing prices and mortgage interest rates; and even recent capital gains tax exemptions. Given the increasing size and complexity of urban housing markets, as well as moving subsidies, it is not surprising that homeowners generally utilize real estate agents, particularly those accessing the computerized, informationally efficient MLS system. Only the Atlantic provinces, Quebec, and the northern territories have failed thus far to exhibit well-developed real estate brokerage markets—but even these should catch up to the rest of Canada by the late 1990s.

Largely due to the computerization of the MLS during the late 1970s and early 1980s, real estate salesperson productivity has grown by about one-

third over the past decade—over twice as fast as productivity growth in the rest of the economy. However, productivity still seems rather low to a casual observer—only four or five properties sold annually per full-time salesperson. Moreover, it seems that only a minority of this productivity growth appears to have been passed on to consumers in the form of lower average commission rates or faster sales for home sellers. Indeed, the secular rigidity of the commission-rate formula implies no readily measured decline in the real price of brokerage services in eastern Canada. In western Canada, the secular growth of some housing prices above $100,000 implies a corresponding decline in average commission rates (from roughly 7 to 6 percent), but this decline has been proportionately less than the increase in productivity (about one-seventh compared to one-third). As a result, brokers, rather than consumers, appear to have appropriated most of the productivity gain in the shortrun. This is conceivably the result of the less than complete evolution of competition among brokers since the "decartelization" of the industry in 1976. Easy entry conditions, together with rigid commission rates, may have inhibited in the past, and may erode in the future, that part of productivity gains reflected in higher than normal earnings for salespersons.

Prior to 1976, the Canadian real estate brokerage industry was organized as a cartel, with the local real estate boards fixing the commission rates for its members at the formula levels still widely observed in today's markets. Members who discounted could be expelled and lose listing access to the MLS. In 1976, the real estate brokerage and other service industries became subject to federal competition laws, and so formal price fixing became illegal. However, unlike the securities industry's commission rate structure after deregulation, real estate brokerage commission rates have generally remained at formula levels. Real or average commission rate levels therefore appear to have persisted in eastern Canada, while they have only declined in western Canada due to the secular inflation of some housing prices beyond $100,000; for example, 7 (5) (4) percent on a house valued at $100,000 ($200,000) ($400,000). Not surprisingly, real estate brokerage profit rates have remained at levels two or three times those for the rest of the economy, in spite of growing levels of costly mass-media, or "brand," advertising.

Commission-formula rigidity, and the corresponding negligibility of any declines in average commission rates, may reflect an insufficiency of competitive behaviour, in spite of the intended decartelization of 1976. One possible "structural" deterrent to competition is the high and rising levels of industry concentration that occurred in the early 1980s, primarily through large brokerage mergers such as that between A.E. LePage and Royal Trust. The recent growth of franchises, such as Re/Max and Century 21, is theoretically more conducive to competition, but it may have done little more than create competition in the market for top salespersons. This is be-

cause franchises typically offer salespersons retention of about 95 percent, rather than the traditional 50 percent, of their commissions. Perhaps in the long term, the full-commission franchises might provide a further stimulus to more widespread discounting of real estate brokerage commissions.

Another contributor to commission-formula rigidity may be the "open pricing" policy of the MLS, whereby catalogues publish listing-agent commission rates and selling broker identities. Other possible causes are the recently alleged restrictions on commission-rate advertising at the retail level imposed by at least one local board, and local boards' denying access by discount brokers to computerized listing services.

Public policy recommendations are several. Federal competition authorities should continue to scrutinize carefully large broker mergers, possible conspiracy and open pricing within the MLS, advertising restrictions, and any predatory or misleading aspects of recent packaging of real estate brokerage and mortgage services. To the extent that the MLS is a natural monopoly, provincial governments should consider legislating an "open" MLS on a trial basis. Home sellers and buyers, wishing to sell and buy privately ("sale by owner"), would then have direct, cost-based access to the MLS, and henceforth a low-cost and effective alternative to transacting through brokers.

Provincial governments should also refuse to introduce or sanction any restrictions on the supply of real estate agents, including quotas and the undue escalation of educational standards. They should also prohibit any restrictions on part-time employment, and resist any undue demands for supervision quotas, e.g., one full-time manager per office, for full-commission companies. They should also ensure that self-regulating broker associations are ultimately accountable to provincial legislatures.

Finally, both federal and provincial governments should become more involved in educating consumers about the nature of real estate brokerage and property resale in general. They could publish brochures highlighting the feasibility of sales by owner, with or without an open MLS; the access to all brokers gained through an MLS listing, even if transacted through a small broker with low listing commission rates; and the feasibility of negotiating reductions in commission rates, especially the rate paid to the listing broker. Together with competitive brokerage markets, consumer information would do much to generate more efficient brokerage and resale housing markets.

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In spite of all of this multitudinous complicity, I alone remain responsible for all errors and omissions.

ABOUT THE AUTHOR

Alexander Jenkins completed his undergraduate studies in economics and commerce at the Royal Military College of Canada in Kingston, Ontario, where he graduated with an Honours B.A. in 1968. After completing a statutory three-year period of service as an officer in the Canadian Forces, he resumed his studies in economics at the University of Western Ontario in London, Ontario, completing the M.A. degree in 1972 and the Ph.D. degree in 1977, with areas of specialization in industrial and labour economics.

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Currently Dr. Jenkins teaches courses in industrial and labour economics at the University of Alberta. He is examining the effects of Canadian competition policy on the service sector and is involved in a study of the effects of licensure and enrolment restrictions on the supply of services, prices, and incomes of dental paraprofessionals.

CHAPTER 1

THE CANADIAN REAL ESTATE BROKERAGE INDUSTRY

INTRODUCTION

Most Canadian homeowners seeking to change residences do so using the services of real estate agents. Those selling their homes typically find themselves remitting commissions to their real estate agents reflecting a long-standing formula: 6 percent in eastern Canada and, in western Canada, 7 percent commission on house values up to $100,000, plus 2.5 or 3 percent on any house value in excess of $100,000 (e.g., a commission of $10,000 on a $200,000 home). In return, they receive the listing and selling services provided through the ubiquitous MLS—Multiple Listing Services operated by their local/metropolitan REB (Real Estate Board). Sellers appear to receive a higher price, perhaps 3 percent more, albeit a lower price net of commission, probably 3 percent less. Buyers arguably receive a better "match." Few homeowners probably wonder why they paid this particular "formula" commission (either the 6 percent, or the 7 and 3 percent values and the $100,000 breakpoint), rather than some other formula; or a flat fee plus a selling bonus; or some alternative commission level or structure. Even fewer will wonder why they transacted through real estate agents rather than "used-house dealers," even though they typically transact in used cars through dealers rather than agents. Finally, very few will find it conceivable that they might have become one of the approximate 7 percent of Canadian homeowners who successfully utilized by-owner selling methods rather than transacting through an agent or hypothetical dealer.

Some of these questions have recently become the subject of formal economic analysis, particularly in the past decade. They, along with other issues, are briefly introduced and given some analysis in this study. Broad statistical descriptions are also provided, both for their own merits, and for their value as inputs into an examination of issues of interest to most of us as consumers, to the industry, and to federal and provincial regulators.

In general, it appears that real estate brokerage has grown more rapidly, in terms of both output and employment, than other services and the economy as a whole during the 1970s and 1980s, mostly because Canadians are moving more often. Real estate brokerage represents about $1.5 to $2.0 billion of current Gross National Procut (GNP), one-third to one-half of 1 percent of all GNP, and 75,000 to 100,000 employees, about two-thirds to three-quarters of 1 percent of all employment. It is more than double the size of the securities industry; about the same size as the legal industry; and about one-quarter the size of the banking industry. It has enjoyed a much higher productivity growth rate than the rest of the economy during the 1970s and 1980s, probably due to the ongoing computerization of the MLS.

Recent investigations by the Bureau of Competition Policy, and the subsequent "regulation deal" with the Canadian Real Estate Association, may prove to be a justifiable response to the industry's failure to generate to date any significant discounting and restructuring of commission rates from traditional formula levels—such as has occurred in stock brokerage. Although commission rates were effectively deregulated by the revisions of Canadian competition laws in 1976, commission formulae have remained roughly unchanged, even to the extent of preserving east-west formula differences. This is somewhat unexpected in view of the deregulation, technological advances, and cyclical swings in real estate brokerage markets during the past decade. At least three explanations are contributive. One is the rapid increase in industry concentration, primarily through merger and "branding" activities in the 1980s. Another is the open pricing policy of the exclusive producers' co-operative known as the MLS. A third is the recently alleged local boards' denial of access by discount brokers to computerized listing services.

In eastern Canada, average commission rates appear to be unchanged. The interaction of the traditional commission formula with secularly increasing housing prices (beyond $100,000) in western Canada implies a very modest reduction in average or "real" percentage commissions. In both cases, resource misallocation may have resulted from formula rigidity. Given inelastic demand, deadweight social loss may be minimal. However, other resource misallocation may be more substantial, particularly any underutilization of labour inputs and rivalrously offsetting promotional activity arising from the interaction of rigid commission formulae with a relatively elastic labour supply, easy entry by small firms, and the emergence of dominant firms. Possible underutilization of labour is reflected in average annual property sales per salesperson of only five, compared to 15 or more in some major companies. Rivalrously offsetting promotional activity takes the form of highly visible, non-price rivalry, including brand advertising and the intense solicitation of listings, some of which may be

judged to be socially wasteful. The recent regulation deal prohibiting price fixing within real estate boards may prove to be a useful policy initiative in dealing with the reality and consequences of commission-rate rigidity in Canadian real estate brokerage. Other policies may be needed to deal with its structural causes.

The background provided below, and, of course, the study itself, provide further insights into these and other issues facing the industry, as well as related government policy recommendations. Since virtually all of us as homeowners have had, or will have, occasion to transact in the resale housing market, readers should find much of the description and analysis, and many of the policy recommendations relevant to personal experience.

BACKGROUND

The typical real estate brokerage client is a family wishing to sell or buy a resale (used) home. However, the family transacts so infrequently as to have very limited knowledge of available properties, prices, advertising and selling techniques, negotiation strategies, written agreements, and so on. Unlike real estate operators, the family maintains no in-house staff of trained and experienced real estate salespersons. Hence it resorts to brokerage, rather than sale-by-owner methods. Nor can the family turn to used-house dealers, because these, unlike their counterparts in the used car market, do not exist and would, in any event, involve unacceptably high bid-ask spreads. This is because dealers' price risk in volatile housing markets is high, while the extra convenience to sellers, and the needs of buyers for dealer reputations and warranties, are minimal.

Real estate brokerage transactions increasingly take the form of "co-operative" or MLS listings and sales—roughly 88 percent in recent normal times, less during booms and more during slumps in housing resale. This partly reflects the rapid computerization of the late 1970s and 1980s, which has increased the relative efficiency of the MLS compared to the alternative, the exclusive listing service (ELS). Relative efficiency gains probably take the form of faster, higher-quality matches and higher selling prices for MLS than ELS properties.

Real estate brokerage has become more brand-intensive. Large traditional realtors, such as Royal LePage, and U.S.-based franchises, such as Re/Max, have greatly increased their market shares in recent years. They have used their ability to exploit economies of scale in brand (mass media) advertising as a key ingredient in the attraction of listings. In addition, by offering their employees a 95-percent retention of gross commissions, rather than the traditional 50 percent, large full-commission brokers like Re/Max have attracted top salespersons from traditional brokers and further increased their market share. Recent packaging of mortgage pre-approval

with real estate brokerage services may have further augmented large firm and franchise market shares.

Largely due to recent computerization of the MLS, labour productivity in real estate brokerage has grown by 2 to 3 percent annually over the past decade—about twice as fast as the rest of the economy. Increased productivity levels, about five rather than three properties sold annually per full-time salesperson, appear to have been largely reflected in increased salesperson earnings and, in western Canada, modestly lower average commission rates as well. However, service quality, as reflected in the speed of sales, appears to be no higher. More vigorous competition may be necessary in order to ensure that more of these productivity gains are passed on to consumers, and to prevent the excess entry of new salespersons (in response to the higher earnings associated with the rigidity of the commission formula) from eroding these productivity gains.

Both output and employment in real estate brokerage grew more rapidly than the rest of the economy during the 1970s and 1980s. They have responded mainly to long-term increases in both the size and rate of turnover of the housing stock, with the typical Canadian homeowner currently changing residence about twice as often as in the early 1970s. Output exhibits a negative short-run response to real mortgage interest rates, and is very inelastically demanded with respect to the commission rate. This is mainly because commission costs are only a minor fraction of the total costs of changing residences. Output and employment demonstrate considerable regional dispersion, with lower levels, but higher growth rates, in the less prosperous provinces. Regional dispersion should be minimal by the late 1990s.

It is noted that the persistence of real estate brokerage commission rates at traditional formula levels in MLS and ELS transactions, in spite of effective deregulation in 1976, contrasts remarkably with the experience of stock brokerage. Significant discounting and restructuring of the commission formula, and hence net reductions in average commission rates, may have been thwarted by several industry characteristics. These potentially include rapidly increasing industry concentration, primarily as a result of merger and branding activities; the open pricing practices of the MLS; the recently alleged local boards' denial of access by discount brokers to computerized listing services; any supply restrictions arising from industry and government escalation of educational, supervision, and full-time employment requirements; and even the introduction of mortgage pre-approval by large realtors. The average profit rates of corporate brokers have accordingly been well above those of other industries. Particular firms have achieved spectacular profitability, such as the industry leader, Royal LePage—45 percent on equity in 1986. Given price-inelastic output demand, the resultant deadweight social loss arising from commissions above, and housing

turnover below, competitive levels are small. However, the growing involvement of large national realtors in mass media brand advertising and individual salespersons in rivalrously offsetting mail, telephone, and door-to-door solicitations of listings, together with high rates of turnover and related underutilization of labour, may be matters for policy concern.

GOVERNMENT POLICY RECOMMENDATIONS

Government policy recommendations include the following items.

1. The federal Bureau of Competition Policy should continue to investigate and prosecute vigorously any violations of the merger, conspiracy, market restrictions, and misleading advertising provisions of the *Competition Act*, especially with respect to large broker mergers, the open pricing policy of the MLS, and any restrictions on access by discount brokers to computerized listing services. Any concerted revision of the current commission formula, for example that involving escalation of the break point above $100,000 in western Canada, should be especially scrutinized.
2. Provincial governments should consider the merits of legislating, possibly on a geographically limited trial basis, direct, cost-based access to the MLS for homeowners, whether sellers or buyers. This, if pursued on a permanent basis, would end the existing exclusiveness of the MLS as a producers-only co-operative thought by some industry observers to display some properties of a natural monopoly in the dissemination of information on property resales.
3. Provincial governments should continue deregulation. They might end licensure, or replace it with certification; eliminate any unreasonable restrictions on the types of commissions permitted; and resist further imposition of pre-licensing enrolment quotas, higher educational standards, supervisory ratios, and full-time status requirements.
4. Provincial governments should circumscribe self-regulation by industry self-regulating organizations (SROs). For example, they might require public representation on SRO governing and disciplinary bodies; limit the scope for the escalation of educational standards; forbid the introduction of enrolment quotas, any restrictions on part-time employment, and any prohibitions on legitimate commission-rate advertising; and incorporate a veto power for the Lieutenant Governor in Council.
5. Both federal and provincial governments should ensure that the packaging of mortgage pre-approval with real estate brokerage services should not become predatory, coercive, or misleading.

6. Both federal and provincial departments of consumer and corporate affairs should become more active in consumer education. They should produce brochures providing information to homeowners on how to sell by owner, with or without using an open MLS; to shop around for a listing broker who offers his or her services at low rates but offers access to the MLS; to negotiate reductions in (listing) commission rates or alternative, more motivating, commission structures; and to make complaints to the SRO or government where service is inadequate.
7. Statistics Canada should disaggregate Standard Industrial Classification (SIC) 735 into "real estate agencies" and "insurance agencies" for all reporting purposes.

CONCLUDING REMARKS

It is anticipated that a combination of ongoing technological innovation via computerization, increased competition for salespersons from full-commission brokers like Re/Max, and appropriate government policies—perhaps even as radical as the promotion of an open MLS—could do much to speed up the evolution of a more competitive real estate brokerage industry, and a more efficient resale housing market in general. These would better serve the homeowner in the immediate future, as well as in the long run. For example, the full evolution of competition and industry rationalization might ultimately double average annual sales per salesperson (from five to ten) and ensure both imminent and long-term halving of commission rates (from roughly 6 to 3 percent), thereby dramatically reducing resource consumption by half. It could also reduce the amount of mass-media brand advertising and solicitation of listings to fully competitive levels. The result—a more efficient brokerage function—would be welcomed by most transactors. Homeowners could choose from a broader spectrum of commission-rate-search intensities, or transact directly through an open MLS. As a result, greater efficiency would arise imminently, not just ultimately, in the brokerage, the by-owner, and the entire resale property markets.

CHAPTER 2

AN OVERVIEW OF THE CANADIAN REAL ESTATE BROKERAGE INDUSTRY

INDUSTRY AND SERVICE DEFINITIONS

According to the Standard Industrial Classification (SIC) system used by Statistics Canada, the real estate brokerage industry is part of SIC 735, Insurance and Real Estate Agencies. It includes those establishments "primarily engaged in dealing in real estate, i.e., renting, buying and selling for others, managing and appraising real estate for others." Real estate agencies are to be distinguished from those establishments engaged in dealing in real estate on their own account, i.e., as principals. The latter include primarily Real Estate Operators (SIC 737) and, in some cases of new structures, Construction (SIC 404-421).

This formal definition of real estate brokerage is consistent with both explicit and implicit industry definitions appearing in other industry studies. For example, it is similar to that used by Rosenbluth (1976, p. 2): the typical firm "finds buyers for real property offered for sale, suitable property for buyers, arranges deals and arranges financing of real estate deals." However, note that the last function listed is an optional, not an integral, part of the real estate brokerage function.

These industry definitions are compatible with the various occupational definitions and descriptions pertaining to the principal employee of the real estate brokerage industry. The real estate salesperson "sells and leases land, houses, apartments, commercial buildings and other real estate for clients. Interviews prospective sellers to solicit listings and advertises properties for sale or lease. Draws up sales or rental agreements. Advises and assists clients in the arrangement of mortgages."[1] This definition incorporates the same emphasis on the agent-client relationship—dealing for others rather than self. It includes the rental as well as selling transaction.

In order to standardize the terminology in subsequent discussion, the term "broker" will be used to describe the owner or manager of a real estate firm. The broker may also be directly involved in the selling of real estate, particularly in smaller firms. The term "salesperson" will be used to describe the employee of a real estate brokerage firm who is directly involved in selling. Finally, the term "agents" will be used to describe brokers and salespersons collectively.

GENERAL INDUSTRY DESCRIPTION

Service Characteristics

As succinctly stated by Rosenbluth (1976, p. 31), "the bulk of real estate transactions serves the purpose of adapting ownership of the heterogeneous stock [of property] to changing needs." As an economically feasible alternative to sales by owners, wherein sellers and buyers seek out and transact with one another without using agents, "the essence of the brokerage function is the bringing together of prospective buyers and sellers" (Crockett 1982, p. 211). Figures 1 and 2 illustrate the market intermediation relations involved in the two types of real estate brokerage services.

Figure 1

Exclusive Listing Service

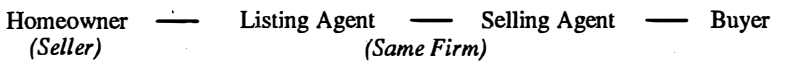
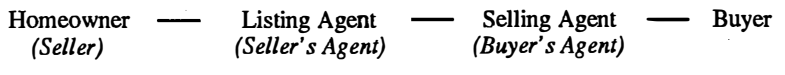


Figure 2

Multiple Listing Service



In the brokerage process, the homeowner or prospective seller approaches, or is approached by, a listing agent with whom he or she negotiates a listing agreement. During the specified term of the listing agreement, the listing agent (or "seller's agent") endeavours to locate a suitable buyer. If he attempts this through his own firm, the listing is exclusive. If he attempts this through any firm, i.e., his or other co-operating agency, it is a "multiple listing." Upon transfer of the property to the buyer,

the listing agent receives a pre-specified commission. If the listing agent locates a buyer, he is simultaneously both listing and selling agent and he receives the entire commission. If a different agent locates the buyer, the commission is split, usually in a pre-specified manner, between the listing and selling agent. Should no suitable buyer be found and the transfer not be effected, the listing agreement lapses and no commission is paid. The seller is then free to renegotiate the listing agreement with that agent, negotiate a new agreement with another agent, revert to sale by owner, or simply discontinue his attempt to sell the property.

The agent performs a number of functions in the listing process, beginning with such ancillary services as property value appraisal and advice on minor improvements and repairs increasing property salability. However, these and other services are ancillary in the sense that the homeowner contemplating selling could purchase these services from other suppliers. The most fundamental service provided by the listing agent is the initial, and repeat, dissemination of information on the property's availability for purchase and its characteristics such as type, size, location, and list price. Both fundamental and ancillary services are typically "bundled" for potential reasons of efficiency and maximizing agent incentives. Bundling may also represent the substitution of non-price rivalry for price/commission discounting.

The listing agent will attempt to locate a buyer with an intensity which varies inversely with the size of the pool of eligible selling agents. Search intensity will be greatest in a small brokerage with an exclusive listing, and the least in a large brokerage with a multiple listing. In the event that a different agent locates a potential buyer, the listing agent acts as a go-between for the buyer's agent and the seller. For example, the listing agent will arrange for inspection of the property upon request from the buyer or the buyer's agent. He also becomes involved in communicating offers and counteroffers during the bargaining process, and advises the seller on the acceptability of any interim offer to purchase.

The selling agent locates a prospective buyer. He is said to be attempting to sell the property and is also known as the buyer's agent. The selling agent collects and holds information on available properties and interested buyers and their needs. He advertises the availability of specific properties, or his general availability, in an attempt to attract buyers for specific or other unadvertised properties. He provides more detailed information to prospective buyers on the specified properties or other unadvertised properties. He arranges any desired inspections with the listing agent. If he is also the listing agent, he deals directly with the property owner. He also communicates offers and counteroffers and advises the buyer on the suitability of any interim offer. As an ancillary service, he may assist the prospective buyer in arranging suitable interim or mortgage financing.

Upon the closing of the deal, the buyer pays the full amount of the agreed purchase price, less any deposit paid at the time of reaching the interim purchase agreement. The seller receives the purchase price, less the commission, which is paid to the listing agent. The listing agent remits an agreed portion to the selling agent, if other than himself. The listing agent remits a modest fee to the co-operative listing service (Multiple Listing Service—MLS), for example, about $35 in Calgary, and $140 in Edmonton. In most cases, salespersons remit a pre-specified portion, usually half, of their commission to their employer/firm/broker. In return, they receive various managerial, office, secretarial, advertising, and other overhead services. In the case of full-commission brokerages, salespersons retain all, or almost all, of their commission, but must remit pre-specified monthly lump-sum contributions to their employer/firm/broker.

The remittance of the entire commission by the property seller to the listing agent, with a subsequent split between listing and selling agent, contrasts with the practice in stock brokerage—there the seller and buyer pay their individual brokers directly. In stock brokerage, the buyer need never know the identity and location of the seller. Hence he cannot recontract without his broker (refuse the purchase initially, but approach the seller directly) to avoid paying a commission. In real estate, such recontracting is possible in view of property inspections, so sellers remit the whole commission.

The proportion of all property sales involving real estate agents is purportedly high, probably in excess of 90 percent of residential sales, although less for non-residential sales and less during resale housing booms (Jud and Frew 1986, p. 21). A significant majority of broker sales, 75 to 90 percent, tend to be MLS sales, although somewhat less so for large brokerages, for non-residential properties, and during resale housing booms. The residual proportion of *bona fide* property sales, i.e., excluding one-dollar transactions within families, is classified as sales by owners. The proportion of sales by owners is small and varies considerably across cities. For example, Islam (1985, p. 264) notes the proportion of sales by owners varying from less than 5 percent to up to 30 percent, with a median of about 14 percent, in a sample of U.S. cities, 1973-74. Islam and Jenkins (1985, p. 63) report a value of about 7 percent for Edmonton in the late 1970s and early 1980s.

Several factors explain the preference of the vast majority of homeowners for agency rather than sale-by-owner methods. Most important are the heterogeneity of the commodity; the infrequency of transactions for individual sellers and buyers; and the financial and legal complexity of the transaction (Crockett 1982, p. 211). Search and information costs, including advertising, time, and psychic costs, are accordingly high. Hence most homeowners purchase agency services in order to take indirect ad-

vantage of substantial network and other economies of scale and specialization in information processing, advertising, negotiating, and transacting.

Hence it is not surprising that empirical studies reveal that the following are statistically significant determinants of the decision to use a real estate agent (Jud 1983): the price of the property; the earnings of the homeowner; whether the buyer is a first-time purchaser, as is true in over one-third of all cases; and whether the homeowner is leaving the region.

Another factor motivating the use of an agent would appear to be the salesmanship effects, whereby agents "generate effects similar to advertising" (Jud 1983) in the form of higher demand and price for resale homes (Jud and Frew 1986, p. 21). Since buyers seem to be willing to pay home prices which are higher by roughly 3 percent than those paid for homes sold by owners, the net out-of-pocket costs to sellers of using agents are only about one-half of the 5 to 7 percent commissions remitted to agents (Jud and Frew 1986, p. 25). Because they can also reduce the search and information costs, as well as the inconvenience, of the sale-by-owner method, sellers are correspondingly motivated to employ agents. Buyers appear to be willing to pay more for agent-sold homes which are a better match for their needs.

A further question not specifically examined in the literature is concerned with the issue of why homeowners use either agents or the sale-by-owner method, rather than transacting with another type of market intermediary—"used-house dealers." This question invites further research, especially when one considers the contrasting popularity of the dealer as opposed to sale-by-owner or agency/consignment method of transacting in used motor vehicles. A possible explanation, outlined in Appendix A, emphasizes the prohibitively high bid-ask spreads which would be generated by a housing dealer market.

Historic Evolution of Service Characteristics

Since the real estate brokerage industry has only become the subject of significant economic analysis during the past decade, it is difficult to develop a time-series analysis tracing the evolution of the industry and its services before the mid-twentieth century. Nonetheless, some time-series and suggestive cross-sectional analyses are possible.

Casual time-series analysis indicates that U.S. commission rates rose from 2 to 3 percent in the 1920s to about 5 percent in the 1950s, to 6 to 7 percent in the 1980s (Crockett 1982, p. 210). Today's commission rates in eastern Canada are typically 5 to 6 percent, while in western Canada, with a growing fraction of housing prices above $100,000, average commission rates are roughly the same (e.g., 6 to 7 percent on the first $100,000, plus 2.5 to 3 percent on the next $30,000, implies an average 5 to 6 percent

commission on a $130,000 home). An undoubtedly large part of this long-term increase in commission rates reflects more intensive and costly search. In addition, the introduction and growth of co-operative listing services (i.e., the MLS) beginning in the late 1950s, typically in larger cities, can be viewed as an efficient response to the increasing size and complexity of resale housing markets. Indeed, it may have facilitated an even better matching process, with sellers receiving a price closer to intrinsic property value, and buyers, although paying a higher price, receiving a property better suited to their needs. Finally, technological advances in the form of computerized listings and buyer matching programmes, as well as video displays, further indicate a potential improvement in the quality and efficiency of brokerage services.

Alternative cross-sectional analysis corroborates these developments. Smaller communities of today arguably replicate the experience of yesteryear in that properties for sale are few in number. Hence properties are sold by owner, by auction, or by exclusive listing rather than through the MLS. During a recent trip to the U.K., the author noted the pervasiveness of such selling methods in even mid-sized cities, with commission rates in the 1.5 to 3 percent range. In such cases, search is probably not as intensive, exhaustive, or even timely.

In a recent analysis of its employment prospects, Daly (1981, p. 4) concludes that real estate brokerage has experienced only slow technological change over the past few decades. Although subject to little structural change, real estate brokerage is seen as having significant potential for future change through computers and video displays.

Another trend involves the bundling of real estate brokerage with other services. Bundling has widespread precedent in earlier years, and current occurrence in smaller communities. The same firm typically offered both real estate and insurance brokerage services—hence the rationale for the combined SIC 735 grouping. However, rarely does one observe such combined firms in today's larger cities. Separate licensing requirements for real estate and insurance agents are one explanation. Another is the tendency of first-time and other homebuyers to place insurance on a newly purchased home with their auto insurance agencies, since auto purchases generally precede home purchases.

A different sort of informal bundling appears to be on the upswing. It involves cases where a real estate broker is affiliated with, and therefore promotes the mortgage product of, a financial institution. Royal LePage, Canada's top realtor, is affiliated with Royal Trust—which is in turn owned by Trilon, a conglomerate which also encompasses insurance companies. It has introduced a property and buyer mortgage pre-approval programme aimed at enhancing its share of both real estate brokerage and mortgage markets. Canada Trust and its real estate division have a similar arrange-

ment, while Re/Max has an arrangement with the unaffiliated Toronto Dominion Bank. There are some predictions that Royal LePage might expand its offerings to include property-and mortgage-related life insurance.[2]

A final trend involves the expansion of franchises such as Century 21, Re/Max and National Real Estate Service, usually as full-commission brokerages. Although discussed below, it should be noted that this trend reflects a growing importance of branding, reputation, and related advertising. Given that the franchise holder can enforce minimum quality standards upon franchises, and given any economies of scale he or she can achieve in advertising, the growth of franchise arrangements is a logical development. Even Royal LePage is considering selling franchises to those smaller communities in which it does not have a branch office,[3] perhaps because it finds it economically infeasible to establish one, e.g., due to the presence of a well-established competitor.

Main Consumers

According to Firestone (1951, p. 159), "housing provides the largest second-hand commodity market that exists." For his sample period (1949), 62 percent of all property transfers were residential and 12 percent were agricultural. In a more recent analysis, Rosenbluth (1976, p. 42) observed that, in B.C. during 1975, about 75 percent of real estate commission incomes were residential, 9 percent commercial, 7 percent agricultural, 4 percent recreational, 2 percent industrial, and 3 percent miscellaneous. Finally, recent MLS reports from the Canadian Real Estate Association (CREA) for 1980-86 suggest that about 85 percent of the total dollar value of properties sold is residential. Hence it would appear that households are the major consumers of real estate brokerage services in the resale of properties, i.e., their homes. A recent survey by Royal LePage found that first-time homebuyers constituted about 36 percent of the total (Tougas 1988).

Employee Characteristics

According to the 1981 census industry and occupation employment statistics, and assuming real estate and insurance agencies have a similar occupational mix, the major occupational proportions in real estate brokerage are as follows: salespersons—56.6 percent; clerical—29.9 percent; and managerial—9.1 percent. Some overlap exists in the salesperson and managerial categories, with managers in smaller agencies also doing some selling. Hence salespersons are the single most important occupational class in real estate brokerage. The CREA *1987 Office Profile* corroborates these findings, with labour costs distributed as follows in the typical real es-

tate brokerage office: salespersons—68 percent; clerical—22 percent; and management—10 percent.

Regarding the educational, age, and other characteristics of the labour force in the real estate brokerage industry, the 1981 census reveals that the typical salesperson has completed high school plus a pre-licensing course of about three months, and other real estate brokerage courses. Clerical workers tend to have the same educational level as the population as a whole (Grade 12), while managers plausibly acquire slightly more education than salespersons by completing a longer pre-licensing course.

According to Rosenbluth (1976, pp. 19-21), the typical age of entry into real estate brokerage for salespersons was age 40 or later, with the median age group 50 to 55 (B.C., 1970s). However, the 1981 census suggests a dramatic change in this pattern, probably due to massive entry of younger salespersons in the 1970s. The median age class for real estate salespersons fell to the early 40s, albeit still somewhat above the mid-30s median for all occupations. Hence real estate has become more often a first rather than a second or third career.

Female real estate salespersons are in a minority, being about 38 percent of all real estate salespersons in 1981, or 30 percent of all full-time, full-year real estate salespersons. These values are marginally lower than those for all occupations (41 and 33 percent respectively); however, women have greatly increased their involvement in real estate sales since 1971. Then, they represented only 24 percent of all real estate salespersons and 17 percent of all full-time, full-year real estate salespersons, compared to 35 and 27 percent of the entire and full-time workforce.

It appears that real estate sales is still primarily a full-time, full-year career. In 1981, full-time, full-year workers constituted about 60 percent of all real estate salespersons, compared to 50 percent for all occupations. However, these values are much lower than in the past. In 1971, full-time, full-year workers constituted about 74 percent of all real estate salespersons. Rosenbluth (1976, pp. 44-45) observed a figure of 92 percent for B.C. in 1975. It would appear that the trend toward part-time or part-year work is less prevalent in real estate sales than in the economy as a whole.

Full-time, full-year real estate salespersons achieved earnings well above the 1981 census average for all occupations. Males earned $24,000 compared to $21,000. Females earned $18,000 compared to $13,000. These discrepancies are possibly explained by longer hours for real estate salespersons in general, and males in particular. Among full-time, full-year real estate salespersons of both genders, considerable variation in annual earnings was evident. Crudely estimated ranges were $13,000 to $102,000 for males and $12,000 to $64,000 for females. A significant number of both male and female real estate sales- persons had earnings below, as well as above, the average incomes for all occupations. Hence it is not surprising

that exit/entry rates were high—up to 20 to 35 percent in some years (Rosenbluth 1976, p. 53, as well as provincial licensing statistics).

Research and Technology

In comparison with the production of other services such as health, medical, education, and legal services, the real estate brokerage process requires only modest inputs of human capital (education and training) and non-human capital (plant and equipment). Salespersons typically have a high school education and undertake a few months of part-time study in preparing for pre-licensing examinations. Agents need only some modest additional part-time study and a year or two of experience as a salesperson before licensing. Earnings plateau after two years, so on-the-job training is minimal (CREA 1976a, p. 31). Modest bonding requirements usually pertain. Non-human capital requirements are minimal. The average brokerage employed less than $100,000 of fixed plant and equipment in 1984, according to Statistics Canada, *Corporation Financial Statistics*, probably in the form of owned rather than rented office space, desks, filing cabinets, typewriters, telephones, computer terminals, and other common office equipment. The primary capital assets of individual salespersons were their automobiles. Nor does there appear to be any indication of significant research and development activity within the aggregate real estate and insurance brokerage industry. Finally, salespersons and agents in small firms earn just as much as they do in larger firms.[4] This is not surprising in view of the long-term survival of small firms and their related widespread participation in the MLS. Hence firm-level economies of scale are arguably minimal, with the probable exception of brand advertising and promotion.

In a recent study of employment prospects, Daly (1981) sees only slow technological change in the real estate brokerage industry. However, he does see increased use of computers in co-operative, and even large firm exclusive, listing and matching applications. This is corroborated by this study, with an indication of a one-third increase in unit sales per salesperson during the 1980s. He also foresees increased use of word processors displacing clerical staff, a trend already apparent by 1981—clerical staff decreased from 34 to 30 percent of all workers in real estate and insurance brokerage between 1971 and 1981. Finally, he speculates that increased use of video displays would reduce the frequency of unfruitful on-site inspections and related transportation and salesperson time inputs.

Generally speaking, however, it would appear that real estate brokerage is not yet a technological or capital-intensive industry. The gross equipment-to-sales ratio actually fell from 13 percent in 1970 to 11 percent in 1984.[5] The bottom line for success in real estate brokerage is salesmanship, and face-to-face encounters would seem to be irreplaceable. The con-

siderable disparity in earnings in full-time salespersons testifies to the greater importance of inherent human personality inputs in relation to purchased inputs of technology and capital. Even higher education seems to be of little advantage in real estate brokerage. Males with some high school (no diploma), a high school diploma, or a post-secondary certificate all earned about $24,000 during 1980; those with university degrees did better ($29,000), but not as well as other university graduates ($31,000).

Perhaps the one additional area in which research and technology might be of imminent importance is in the area of property value appraisal. Computer analysis, perhaps developing and implementing hedonic price indices, could do much to provide greater speed and accuracy in establishing intrinsic market values and property listing prices. It would be surprising if larger firms operating in larger cities were not already exploring this possibility.

Role of Government

Government has played a large and, until recently, an increasing role in the licensure and regulation of real estate brokers and salespersons. Each provincial government has enacted a Real Estate Licensing Act, or equivalent, and typically established a Superintendent of Real Estate and/or Insurance. The Superintendent issues licences to qualified practitioners; receives and acts upon complaints; and co-operates with a legislatively recognized and largely self-regulating real estate association or institute in establishing educational, experience, bonding, and other programmes and standards for the purposes of licensing practitioners on an initial and renewal basis. The Act also often establishes a Real Estate Council which functions as a government/industry co-ordinating body in the disciplinary, appeal, and general regulatory process.

In one province, B.C., the degree of licensure became temporarily restrictive during the mid-1970s. The B.C. Real Estate Council felt that ease of entry into licensed status had resulted in a glut of agents and depressed earnings. Accordingly, it limited new enrolments in pre-licensing courses during the mid-1970s to about 600 per year. However, in recent years, most governments have begun to relax licensing restrictions to the point that some provinces, e.g., Alberta in February 1985, actually discontinued formal licensing requirements for salespersons. Some provinces, such as B.C., have begun to delegate the licensing and discipline functions to the provincial real estate association/institute.

In a few, possibly desirable, respects, provinces have increased the degree of regulation. Some, such as Alberta, have introduced a compulsory province-wide liability insurance programme for real estate agents. Many have introduced a requirement for the filing of prospectuses by foreigners attempting to sell their real estate to Canadian residents.

The federal government has only limited jurisdictional and constitutional powers in the area of real estate brokerage. Most significantly, beginning in 1976 with the extended application of the Combines Investigation Act (now the Competition Act) to the real estate and other service industries, it has effectively prohibited the former practice of fixing commission rates by local real estate boards. However, there has been little indication of frequent and significant discounting below the pre-1976 formula levels of commission rates,[6] while the relative stability of housing prices in western Canada implies little reduction there in average commission rates. The Director of Investigation and Research has warned at least one local real estate board to ensure that agreements on splitting the commission between listing and selling agents do not have the effect of setting a minimum commission rate.[7] He has also refused to act on a complaint by Quebec real estate brokers concerning "predatory" commission rates (2 to 5 percent) involved in a rival computerized real estate listing service provided by notaries.[8] The federal Department of Consumer and Corporate Affairs has, on at least two occasions (Montreal, 1981, and Toronto, 1986), mediated disputes which would have led to the larger real estate brokers establishing a separate multiple listing service. Large brokers felt that their sales share was too much below their listings share as a result of aggressive selling by smaller brokers. They accordingly threatened to set up their own MLS. The Bureau of Competition Policy has also recently negotiated a regulation deal with the Canadian Real Estate Association to end restrictions on discounting by members of certain local boards.[9]

Industry Associations

The vast majority of agents, and virtually all those of large brokerages, especially in larger communities, are members of a local real estate board (REB). There are currently about 124 REBs across Canada. REBs are members of a provincial real estate association or institute, which in turn is a member of the Canadian Real Estate Association. All of these organizations tend to have separate broker and salesperson divisions. They are considerably involved in administering pre-licensing and continuing education programmes, as well as exercising certain self-regulatory functions. REBs are especially active in establishing and policing ethics, primarily in inter-broker relations such as any violation of commission-sharing arrangements between listing and selling brokers. Provincial and Canadian real estate associations are also active in lobbying for legislative reforms.

Of special interest is the role of local REBs in establishing and operating co-operative listing services—the Multiple Listing Service or MLS. The MLS is viewed by some analysts, such as Rosenbluth (1976, chapter 10), as a natural monopoly, and is, in some respects, operated in a manner similar

to a non-profit hospital in maximizing physician incomes.[10] It typically involves the payment of very nominal fees. These fees are much smaller than the extra commission paid by the homeowner for an MLS transaction, e.g., $35 compared to $1,000.

There is some indication of abuse of the MLS involving local boards' denying access to computerized listing services by discount brokers. However, the potential for abuse of the MLS monopoly is limited by several factors. Non-member and discount brokers can still sell, although not list, MLS properties. All brokers can sell exclusively. Finally, homeowners can sell on their own. Overall, the MLS, it is hoped, enhances competition by permitting small brokers to compete with large brokers through access to network economies. However, Rosenbluth argues that the MLS could become even more pro-competitive if it were open to direct homeowner access. Specifically, if anyone, agent or homeowner, whether seller or buyer, were permitted direct access to MLS listings in return for a cost-based fee, member agents would be forced to provide lower-priced, cost-efficient brokerage services. A large proportion of homeowners would still deal with brokers, especially if commissions were lower. Brokers would still offer convenience, a better selling price—by 3 percent, according to Jud and Frew (1986, p. 25)—and probably a faster sale. The important point is that homeowners would be offered a wider range of options in an open MLS system.

Government Statistics

Data for the real estate brokerage industry are collected and published in aggregated form by both federal and provincial governments. However, federal government data, as published by Statistics Canada, suffer from a major weakness: data for real estate brokerage are typically aggregated with those for insurance brokerage into SIC 735, and even with real estate operators (SIC 737) into SIC 9:03. The following Statistics Canada publications suffer from these failings:

1. 61-207 (annual 1965-84) *Corporation Financial Statistics.*
2. 61-005 (monthly 1977-85) *Gross Domestic Product by Industry.*
3. 61-213 (annual 1971-84) *Gross Domestic Product by Industry.*
4. 61-516 (occasional 1961-71) *Real Domestic Product by Industry.*
5. *Census* (decennial 1961, 1971, 1981), especially *Population: Income and Industry.*

6. 72-002 (monthly March 1983 to date for full sample) *Employment, Earnings and Hours.*

Other Statistics Canada sources providing ancillary data for the analysis of real estate brokerage activity include the following:

7. 62-535, 536, 537, 541, 544, 547, 550, 555 occasional; (some years, 1969-86), surveys of *Family Expenditure*, notably changes of residence frequencies.
8. 64-202 (annual 1956-86) *Household Facilities and Equipment*, notably housing stock values.
9. 64-003 (monthly 1980-85) *Service Bulletin, Construction Statistics*, notably occupied and total housing stock values.
10. A064A-20-07-86 (occasional 1978 and 1984) *Business Microdata Integration and Analysis.*

Another federal government data source for the specific analysis of real estate brokerage is published by Revenue Canada:

11. *Taxation Statistics*, (annual 1961-85).

A possible federal government data source will be the anticipated reports of the Director of Investigation and Research, Department of Consumer and Corporate Affairs, examining the operation of nine local REBs. Publication should closely follow the completion of investigations and Order of Prohibition.

Provincial government data sources are publicly available in some provinces but not in others. They take the form of annual reports by the Superintendent of Real Estate and/or Insurance—typically an official of the provincial Department of Consumer and Corporate Affairs or equivalent. These data typically reflect the stock and flows of licences for real estate brokers and salespersons. However, some provinces have recently dropped the formal licensing requirement for salespersons. Others are privatizing the licensing function to industry associations. Others refuse to provide or refrain from providing data to researchers, including this author. Hence these data sources are becoming increasingly incomplete.

Provincial Registry and Land Title Offices keep records which could be an important source of data on property transfers. However, they typically fail to provide any distinction between property transfers with and without structures; types of property; real as opposed to nominal transfers; and agent as opposed to sale-by-owner transactions. They also still process information manually in some jurisdictions and hence records are difficult to access.

Municipal tax records are another data source for property transfers. Again, however, data tend to make few useful distinctions and are usually made available to researchers in aggregate form only.

Various industry data sources also exist, but these tend to be incomplete. For example, the Canadian Real Estate Association publishes data only on MLS sales (1956-1986, per table 1) and on its own membership (1960-86, but only for some years).

Another industry data source is available in disaggregated form—property transfers for four major Canadian cities (Montreal, Toronto, Edmonton, and Vancouver). Since data are collected from land registry and municipal tax records, they suffer from a failure to make useful distinctions such as type of property and structures. More significantly, they are only available at high cost to academic researchers. These data are collected and sold by TEELA Data Management Systems (a division of Moore Corporation Limited) of Scarborough, Ontario.

Regional Differences in Production

Real estate brokerage markets are to a large extent localized, given the importance of local housing market knowledge and provincial licensing. Hence regional differences in production are expected to be minimal. However, offsetting this is the tendency of large national brokers to centralize certain overhead or firm-level functions such as finance and advertising. In addition, interprovincial differences undoubtedly exist in the rate of turnover of the housing stock, with rates higher in the more urbanized, prosperous provinces such as Ontario and B.C. A greater tendency to use brokers rather than sale-by-owner methods is also expected in prosperous urban provinces.

Regional concentrations in real estate brokerage employment are apparent from both census and industry sources. In 1981, Ontario had 42 percent of all real estate salespersons, compared to 37 percent of the entire Canadian workforce. By contrast, Quebec had only 14 percent of real estate salespersons, compared to 25 percent of the workforce. In terms of MLS sales, Ontario had 52 percent during 1985 while Quebec had only 10 percent, compared to their owned housing stock shares of 37 and 23 percent respectively. Clearly many factors contribute to such discrepancies and these are further examined in a later chapter.

Importance of Imports and Exports

Again, since real estate brokerage is a localized industry, little foreign trade is expected. It is believed that households and small businesses, wishing to

Table 1

Summary of Total MLS Activity, Canada, 1956 to 1986

Year	$ Volume (000s)	Yr/Yr % Change	Unit Sales	Yr/Yr % Change	Average Price	Yr/Yr % Change	New Listings	Yr/Yr % Change	S/L Ratio
1956	251,591	—	20,978	—	11,993	—	56,968	—	36.8
1957	313,635	24.7	24,539	17.0	12,781	6.6	69,220	21.5	35.5
1958	377,166	20.3	27,286	11.2	13,823	8.1	84,899	22.7	32.1
1959	436,511	15.7	30,723	12.6	14,208	2.8	100,428	18.3	30.6
1960	445,277	2.0	31,389	2.2	14,186	−0.2	102,672	2.2	30.6
1961	455,346	2.3	32,233	2.7	14,127	−0.4	103,227	0.5	31.2
1962	494,085	8.5	34,543	7.2	14,303	1.3	119,537	15.8	28.9
1963	561,459	13.6	38,935	12.7	14,420	0.8	121,611	1.7	32.0
1964	696,434	24.0	46,231	18.7	15,064	4.5	122,945	1.1	37.6
1965	841,628	20.8	52,875	14.4	15,917	5.7	130,448	6.1	40.5
1966	1,020,393	21.2	58,189	10.1	17,536	10.2	140,822	8.0	41.3
1967	1,239,474	21.5	64,855	11.5	19,111	9.0	139,651	−0.8	46.4
1968	1,480,877	19.5	69,616	7.3	21,272	11.3	158,327	13.4	44.0
1969	1,714,294	15.8	73,784	6.0	23,234	9.2	182,676	15.4	40.4
1970	1,650,758	−3.7	70,619	−4.3	23,376	0.6	209,306	14.6	33.7
1971	2,118,529	28.3	86,185	22.0	24,581	5.2	213,047	1.8	40.5
1972	2,507,521	18.4	94,285	9.4	26,595	8.2	197,307	−7.4	47.8
1973	3,460,710	38.0	107,123	13.6	32,306	21.5	195,395	−1.0	54.8
1974	4,564,021	31.9	111,163	3.8	41,057	27.1	277,109	41.8	40.1

Continued on next page

Table 1—*Continued*

Summary of Total MLS Activity, Canada, 1956 to 1986

Year	$ Volume (000s)	Yr/Yr % Change	Unit Sales	Yr/Yr % Change	Average Price	Yr/Yr % Change	New Listings	Yr/Yr % Change	S/L Ratio
1975	6,659,812	45.9	145,163	30.6	45,878	11.7	336,042	21.3	43.2
1976	7,295,066	9.5	142,040	–2.2	51,359	11.9	418,282	24.5	34.0
1977	8,681,873	19.0	161,110	13.4	53,888	4.9	487,176	16.5	33.1
1978	9,836,571	13.3	173,678	7.8	56,637	5.1	506,743	4.0	34.3
1979	12,005,270	22.0	192,130	10.6	62,485	10.3	534,535	5.5	35.9
1980	13,491,497	12.4	192,880	0.4	69,948	11.9	511,486	–4.3	37.7
1981	15,453,285	14.5	196,383	1.8	78,690	12.5	616,065	20.4	31.9
1982	12,900,444	–16.5	177,178	–9.8	72,811	–7.5	656,271	6.5	27.0
1983	16,246,828	25.9	210,390	18.7	77,222	6.1	610,565	–7.0	34.5
1984	17,190,013	5.8	222,762	5.9	77,168	–0.1	626,156	2.6	35.6
1985	24,127,252	40.4	293,256	31.6	82,274	6.6	628,869	0.4	46.6
1986	30,130,084	24.9	311,021	6.1	96,875	17.7	666,217	5.9	46.7

Source: CREA. *Annual Statistical Survey, MLS*, 1986.

transact in real estate across international boundaries, generally do so as part of a permanent change of country of residence. Hence no true import or export occurs. In addition, foreign-based real estate agents are not permitted to act across borders in view of provincial licensing arrangements. They would, in any event, be disadvantaged in terms of knowledge of local housing market conditions and the provision of on-site inspections and negotiations.

One notable exception arises in the area of the sale of real estate brokerage franchises. Agents associated with U.S.-based franchises such as Re/Max and Century 21 typically remit monthly payments, fixed fees, or a small percentage of brokerage commissions to the Canadian and ultimately to the U.S. franchise holder. However, these payments appear to be small, e.g., 0.4 percent of all brokerage outlays during 1987.[11]

INDUSTRIAL ORGANIZATION

Ownership Types

In 1984, 31,161 corporations in SIC 735 reported to Statistics Canada.[12] In the same year, only 4,011 insurance and real estate brokers operating as sole proprietors filed income tax returns.[13] Hence it would appear that largely *corporate* ownership and organization characterize the real estate (and insurance) brokerage industry. Another source, the CREA *1987 Office Profile*, indicates that about 77 percent of real estate brokerage offices responding were operated by private companies; 7 percent by public companies; 13 percent by sole proprietors; and 4 percent by partners.

It would appear that the dominance of the corporate ownership type is motivated by taxation and liability advantages. Over three-quarters of all offices were associated with a single office brokerage. About one-half of all offices had five or fewer salespersons. Capital requirements are minimal even among corporations, with average assets about $300,000 and equity $80,000 per firm. Finally, agents in small firms earned about as much as agents in large firms, suggesting that firm-level economies of scale are unimportant.[14]

Size Distribution of Firms

Considerable variation is apparent in the observed size of real estate brokerage firms. According to the CREA *1987 Office Profile*, there were a total of 7,500 member offices during 1986, employing a *maximum* of 69,000 CREA member brokers and salespersons. For responding offices, 77 percent belonged to small one-office brokerage firms; 11 percent belonged to medium-sized, two to ten-office brokerage firms; and 12 per-

cent belonged to large, eleven-or-more office, brokerage firms. This would suggest low industry concentration. However, it seems plausible that large firms operate most of the 6 percent of all offices employing more than 30 licensees. The franchised status of many firms may also invite an upward re-interpretation of *effective* concentration levels. Moreover, the localized nature of real estate brokerage would lead to local/regional concentration levels well above national levels.

In his study of B.C. real estate brokerage, Rosenbluth (1976, p. 9) found the top three firms had about 20 percent of the entire market. In studies of the Edmonton MLS real estate brokerage market, Islam (1985) and Islam and Jenkins (1985) observed modest but rising concentration levels. The market share of the top four firms in Edmonton (CR_4) rose from 24 percent in 1971 to 54 percent in 1983.[15] In addition, a national market share analysis of major Canadian real estate brokers appeared in the *Financial Times* (September 22, 1986, p. 35). Largely as a result of mergers and franchise growth, CR_4 rose from 44 percent in 1984 to 74 percent in 1985. Even if the Re/Max, Century 21, and National Real Estate Service (NRS) franchises are treated as groupings of small *independent* firms, CR_4 rose from 34 to 47 percent between 1984 and 1985.

These measured concentration levels could be interpreted as suggestive of even higher and more rapidly growing effective concentration levels, or even potential market power, in a number of respects. First, a recent merger between Canada Trust and Canada Permanent Trust, effective December 31, 1985, further escalates national concentration levels, since respective market shares were 3.9 and 9.8 percent. Second, brokerage markets tend to be localized. Hence recently reported national concentration levels, CR_4=47 to 74 percent, understate provincial/urban concentration levels to some extent. This is especially true if some brokers are locally large but nationally small. Third, the interurban market is undoubtedly dominated by the few, heavily-advertised, national realtors who operate in many cities. Hence concentration in the interurban segment of the real estate brokerage market is potentially higher than suggested by the aggregate values. Fourth, Daly (1981, p. 56) suggests that commercial real estate brokerage may be even more concentrated than residential real estate brokerage, as it is dominated "by very large national brokerages with a specialized commercial staff." Finally, the existence of such strong producer associations as the local real estate boards, together with their control of the MLS, further enhances the potential market power consequences of the reported concentration levels.[16]

At least two observations suggest that the effects of increasing concentration in generating actual market power have been greatly mitigated to date. First, entry remains relatively easy. Second, in western Canada, while nominal (formula) commissions remain relatively constant, real or average

commission rates have fallen as housing prices have escalated above the break point of $100,000. Future revisions of this formula, especially the break point, will partly reflect any implications of concentration for market power.

Franchising

Franchises are a fairly recent and rapidly growing segment of the Canadian real estate brokerage market. The largest, with corresponding 1984 and 1985 market shares, are as follows: Re/Max, 11 and 21 percent; Century 21, 9 and 13 percent; and National Real Estate Service (NRS) 7 and 8 percent. Century 21 has recently expanded its franchises to the U.K.[17] Re/Max has been the centre of much controversy in recent years. Formed in the late 1970s, Re/Max owes much of its success to its full commission policy. It is able to recruit top salespersons from other brokers by offering them retention of 95 percent of earned commissions—compared to the traditional 50-percent split between salesperson and company.[18] It has had similar success in recruiting licensed brokers, who retain 100 percent of commissions. In return for overhead, advertising, and franchise services provided, however, salespersons and brokers remit $1,000 to $1,300 monthly to the franchise holder. Re/Max has been accused of failing to recruit and train new salespersons, not a surprising result in view of its preclusive monthly overhead levy. It has also been alleged, although not demonstrated, that it has failed to provide adequate supervision, to the point of a greater frequency of client complaints of unethical or incompetent performance. It has recently countered Royal LePage's mortgage pre-approval programme with a similar arrangement with the Toronto Dominion Bank.

An analysis of franchising in real estate brokerage is provided by Frew and Jud (1986). Franchising is seen as a market response to a divergence between a small minimum efficient scale for production, especially in an MLS system, and a large efficient scale in brand advertising and promotion. Franchising encompassed about 30 percent of all U.S. real estate brokers in 1981, with further growth averaging 7 percent annually thereafter. Franchise affiliates paid an initial franchise fee of about $4,000 and about 5 percent of subsequent commissions. They tended to sell higher priced properties and achieved greater total commission revenues. Franchised realtors enjoyed a net profit rate of about 100 percent annually on franchise outlays.

In Canada, both Re/Max and Century 21 are U.S.-based franchises, while NRS is a Vancouver-based franchise which grew out of the former Block Brothers company several years ago—and which plans expansion into the U.S.! Together franchises attained over 40 percent of Canadian real estate brokerage sales in 1985, with rapid growth rates—53 percent be-

tween 1984 and 1985. Even Royal LePage threatens to begin a subsidiary franchise programme aimed at smaller communities where it currently has no company office.

A quasi-franchise arrangement has emerged from the recent establishment of a network involving real estate brokerage of commercial properties in nine major cities. A group of small independent realtors has formed Canadian Commercial Real Estate Network in direct competition with Royal LePage and Colliers. It has plans to expand its membership to five other cities and is affiliated with the Office Network in the U.S.[19]

Foreign Ownership

There is no evidence of significant foreign ownership in the Canadian real estate brokerage industry, other than the franchise rights ultimately owned by the U.S.-based Century 21 and Re/Max. This is not surprising in view of industry characteristics, which diverge from those of the typical foreign-owned enterprise. Gorecki (1980) and others identify the profile of the typical foreign-dominated industry: large capital investment requirements; high research and development intensity; high advertising intensity; high tariffs; and minimal regulatory impediments to foreign ownership. Real estate brokerage clearly differs from this profile in most respects. It is subject to only minimal production economies of scale, other than those exploited through the MLS, and modest capital intensity; hence capital investment requirements are small. It is only minimally involved in research and development. It has some considerable involvement in brand name advertising, especially in recent years, but has pursued franchise arrangements in order to exploit any economies of scale in advertising. It deals in a service which is local in nature, producing a situation equivalent to very high tariff barriers to trade. In particular, its local nature places foreign entrepreneurs at some disadvantage in view of their higher costs of obtaining and using knowledge of local conditions. Finally, large national real estate brokerage firms (Royal LePage, Canada Trust, Canada Permanent Trust) are affiliated with trust companies which were, until recently, subject to foreign ownership restrictions.

THE INFORMATION REVOLUTION

Undoubtedly the single most important development in information technology occurred in the Canadian real estate brokerage industry in 1956. A "photo co-op" system, known as the Multiple Listing Service, or MLS, was eventually adopted by over 124 local real estate boards (REBs). It received and published MLS properties from listing agents in a biweekly catalogue, with off-week updates of new listings. Catalogues were circulated to REB

member agents, providing them with a photograph and details on location, size, age, type of home, taxes, mortgage, and listing agent, for all properties still listed but not sold in each neighbourhood of the metropolitan area. Catalogues were searched manually. They were subject to one major weakness—no updates on listed properties which had been sold since the date of publication. Hence agents would have to contact the listing agent in order to determine whether the property was still available for sale. Listing catalogues were complemented with a monthly sales summary which became very useful in the appraisal of future listings.

Listing and sales catalogues provide information to brokers on implicit market shares and commission rates. The identity of the listing broker and the offered (though not negotiated) selling agent's commission rate for each property are vital information to agents contemplating attempts to sell the MLS property. However, it is at best unnecessary, and at worst conducive to cartel stability, that the identity of selling agents and actual commission rates and splits would be published.[20]

A more recent and related development is the computerization of the MLS. Beginning in the late 1970s, REBs began to convert the production of the MLS catalogues to a computerized, advanced word processing basis. In the early 1980s they began to offer direct time-sharing access to the MLS listings, which were more or less continuously updated for deal-pending and sold status and for additional listings. Members with remote terminals were also able to conduct a "market evaluation" or search for properties of specific neighbourhood and other characteristics. In the mid-1980s, REBs began to offer on-line access to members involving updated listings, search, mortgage rates, taxes, and open houses, as well as more than 100 "information fields" on each listed property—far more than the traditional catalogue listings. In the Edmonton REB, over 62 percent of all member offices and over 86 percent of all member agents use the on-line system. MLS catalogues are still produced and circulated, primarily for the photographs and for non-automated members.

The expansion of on-line access, often by microcomputers, to the MLS would suggest that many real estate brokers have also computerized their exclusive listing services (ELS). Large brokerage firms with multiple offices, such as Royal LePage, especially benefit from an automated ELS system.

The use of word processing equipment has undoubtedly increased among real estate brokers. The relative decline in the employment of clerical workers corroborates this trend. As a percentage of total real estate and insurance brokerage employment, clerical employment declined from 34 percent in 1971 to 30 percent in 1981.

Daly (1981) suggests one further development in information technology for the future. Video displays are seen as one method of pre-screening

properties. A *moving* picture is arguably worth a *million* words, or at least eliminates a fruitless on-site inspection. Video displays would be especially useful in cases of interurban moves. They would greatly economize on the number of, and time and transportation resources devoted to, on-site inspections, and could even be provided in conjunction with the computerized MLS/ELS listing services. At least one company, Royal LePage, is considering a pilot project in this area.

Further indirect evidence of the information revolution in real estate brokerage is found in Statistics Canada's *Corporation Financial Statistics*. Between 1973 and 1984, repair and maintenance expenditures in SIC 735 (real estate and insurance brokerage corporations) increased from 0.33 percent to 0.84 percent of all expenditures; rent for other than land and buildings increased from 0.29 to 0.46 percent; and the value of equipment and other assets increased from 7.5 to 11.3 percent of all assets. It is reasonable to assume that a large part of these increases involved computer and word processing equipment and technology.

NOTES

1. Alberta Treasury, Bureau of Statistics, 1985, p. 174.
2. Ferguson 1986, pp. 42-46.
3. Ibid., p. 46.
4. Rosenbluth 1976, p. 48.
5. Statistics Canada, *Corporation Financial Statistics* 1970 and 1984.
6. Islam and Jenkins 1985.
7. Canada, Director of Investigation and Research, 1982, p. 46.
8. Director of Investigation and Research 1985, p. 51.
9. "Canadian Realtors," 1988, p. D2, and Canada, Department of Consumer and Corporate Affairs, 1988b.
10. Pauly and Redisch 1973.
11. CREA 1987, p. 1.
12. Statistics Canada, *Corporation Financial Statistics.*
13. Revenue Canada, *Taxation Statistics.*
14. Rosenbluth 1976, p. 47.
15. Coincident with the rapid rise of concentration in the early 1980s was a virtual disappearance of the commission-rate discounting which had begun to emerge in the late 1970s (shortly after formal fixing of commission rates by the local REB became illegal with the 1976 revisions to the Combines Investigation Act).
16. Saving (1970) and Hause (1977) link concentration to market power. Islam and Jenkins (1985) note the virtual disappearance of commission-rate discounting in the Edmonton MLS market coincident with the increasing concentration levels.
17. Snyder 1987, p. G3.
18. Ferguson 1986.
19. Gilmour 1987.
20. Osborne 1976; Spence 1978.

CHAPTER 3

INDUSTRY OUTPUT: LEVELS, DESTINATION, AND INTERDEPENDENCIES

LEVELS OF PRODUCTION AND SALES

The output of real estate brokerage is local in both production and sales, with no inventory accumulation in the usual sense. Hence production and sales are treated as equivalent in value and trend. Output can be measured using both government and industry data sources. Unfortunately Statistics Canada aggregates real estate agencies with insurance agencies into Standard Industrial Classification (SIC) 735, and sometimes with real estate operators into SIC 9:03. Hence, it is possible to obtain only an approximate indication of the level and trend of real estate brokerage output using published government sources. In addition, industry sources typically report only sales of MLS properties by member agents, as opposed to sales of all properties whether MLS (Multiple Listing Service) or ELS (Exclusive Listing Service). Therefore it is again possible only to approximate industry output and trends using published industry data sources.

Three major Statistics Canada data sources (catalogue numbers 61-005, 61-213, and 61-516) provide data for the gross output (GO) and Gross Domestic Product (GDP) of SIC 9:03—combined SIC 735 and 737, insurance agencies and real estate industry. For example, GO and GDP for SIC 9:03, in current dollars, were $22,665 and $12,628 million respectively in 1981. But how much of this economic activity was attributable to real estate agencies alone?

By using two other Statistics Canada sources (catalogue number 61-207, *Corporation Financial Statistics*, and the 1971 and 1981 census), it is possible to apportion first the output of SIC 9:03 between SIC 735 and SIC 737; and then the output of SIC 735 between real estate agencies and insurance agencies. In 1981, SIC 735 firms had income or output which was 16.7 percent of total SIC 9:03 output, i.e., $3.8 billion of $22.7 billion. In 1981, 63.4 percent of combined insurance and real estate salespersons in

SIC 735 were real estate salespersons (occupational code 5172). Hence roughly the same percentage of output for SIC 735 is attributable to real estate agencies (REAs), i.e., $2.4 billion of $3.8 billion. In share terms, the output of REAs constitutes 63.4 percent of SIC 735; 10.6 percent of SIC 9:03; 3.7 percent of SIC 9 (finance, insurance and real estate, or F.I.R.); and 0.3 percent of all industries' output. The estimated output share of REAs compares poorly with its corresponding employment share for F.I.R. (11.5 percent), but somewhat better with its employment share for all industries (0.6 percent). It would appear that REAs are much more labour-intensive than F.I.R., and somewhat more labour-intensive than "all industries."

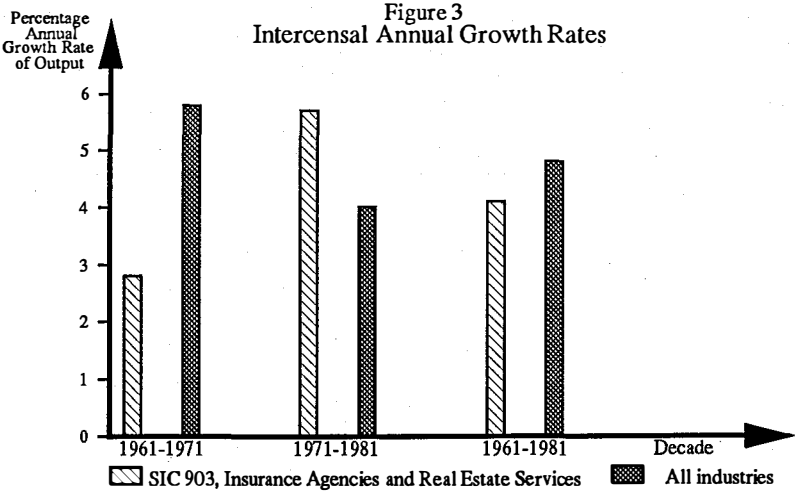
An alternative data source for estimating REA output is provided by industry reports. The total market for residential real estate brokerage services involved annual commissions of about $1.0 billion in 1984 and 1985, and $1.5 billion in 1986 and 1987. MLS commissions on residential sales were about $1.2 billion in 1986 and 1987.[1] Since MLS annual reports indicate that non-residential MLS sales were about 20 percent of residential values in 1984 and 1985, total commission income during 1984-87 would be in the range $1.2 to $1.8 billion annually. Adding in an estimated 23 percent for non-commission revenue (per Statistics Canada *Corporation Financial Statistics*), total REA annual output in 1984-87 would be in the range $1.5 to $2.2 billion, or about 0.2 percent of all industries' output.

The industry estimate of REA output share is about one-third less than the imputed Statistics Canada output. Aside from any inaccuracies in the imputations, perhaps industry sources under-report Canadian Real Estate Association (CREA) non-member sales; or non-MLS residential and all commercial sales are under-reported; or 1984 was a slower year for REAs than 1981.

In terms of the real annual growth rate of industry output, real GDP in SIC 9:03 increased at average annual rates which were similar to those for all industries over the period 1961-81, about 4 or 5 percent. However, it increased much less rapidly during the 1960s, and more rapidly during the 1970s (see figure 3).

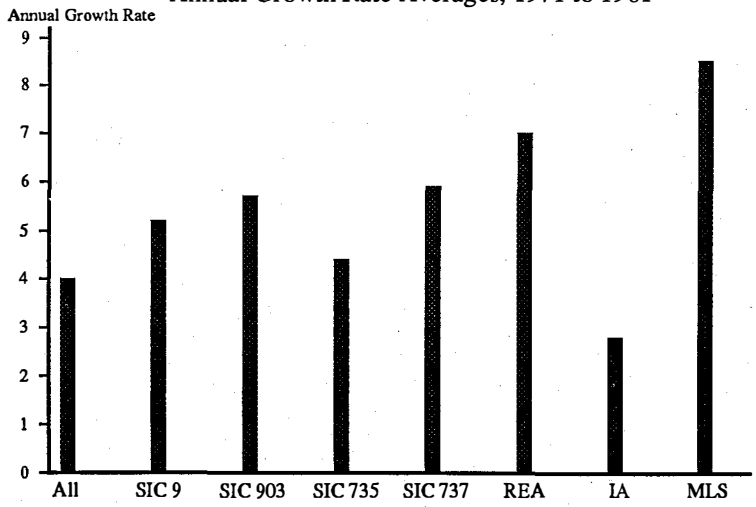
Apportioning the output of SIC 9:03 between SIC 735 and 737 according to 1971 and 1981 corporate income levels for "real estate and insurance agencies" and "real estate operators" respectively, real output in SIC 735 grew at an average annual rate of 4.4 percent, a rate below that of SIC 737 (5.9 percent); SIC 9:03 (5.7 percent); and SIC 9 (5.2 percent), but above that for all industries (4.0 percent). Apportioning the output of SIC 735 between "real estate agencies" and "insurance agencies" according to 1971 and 1981 employment of real estate salespersons (5172s) and insurance salespersons (5171s) in SIC 735 (according to the census), the real output of real estate agencies grew at an average annual rate, 1971-81, of 7.0 percent. Hence while combined real estate and insurance agencies have had

Figure 3
Intercensal Annual Growth Rates



Note: Average annual growth rates derived from GDP ($1971), Statistics Canada, Gross Domestic Product by Industry.

Figure 4
Annual Growth Rate Averages, 1971 to 1981

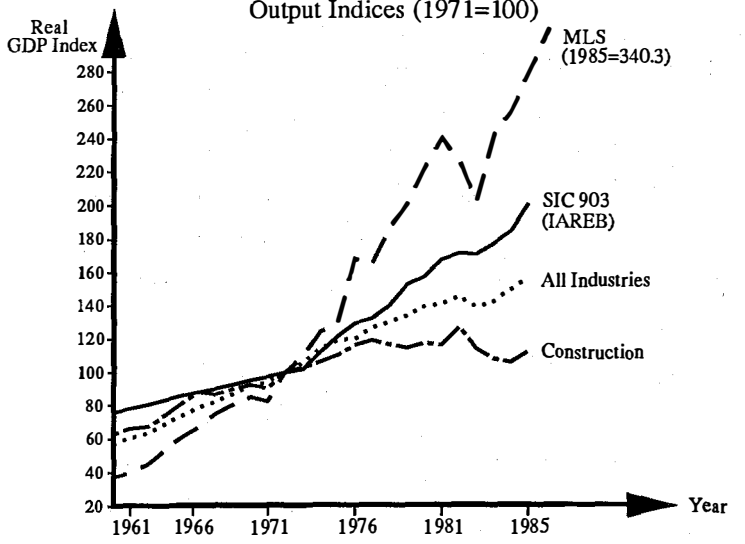


Source: Average year-to-year percentage change in GDP ($1971) per Statistics Canada, *Gross Domestic Product by Industry* (catalogue 61-213), and Canadian Real Estate Association, *Annual Statistical Survey, MLS, 1986.*

Note: All is all non-agricultural industries; SIC 9 is Finance, Insurance and Real Estate; SIC 903 is Insurance Agencies and Real Estate Business; SIC 735 is Insurance and Real Estate Agencies; SIC 737 is Real Estate Operators; REA is Real Estate Agencies; IA is Insurance Agencies; MLS is property units sold on the MLS.

modest growth experiences, 1971-81, real estate agencies alone have had a well above average experience. Figure 4 portrays the average 1971-81 annual growth rates, while figure 5 portrays the year-by-year trend in the output of selected sectors and industries, with 1971 being the index year. Note that SIC 9:03 is only modestly cyclical compared to the construction sector, and closely follows the trend for SIC 9.[2] MLS sales have grown very rapidly, but with considerable volatility.

Figure 5
Output Indices (1971=100)



Note: Output is measured as GDP ($1971) for All Industries, Construction, and Insurance Agencies and Real Estate Business (IAREB) per Statistics Canada, catalogue 61-005, 61-213, 61-516.
MLS output is properties sold per CREA (1985).

COMPOSITION OF SALES

It appears that the vast majority of service production in the real estate brokerage industry is directed toward individual consumers or households. Recent MLS statistical surveys (1980-86) indicate that about 85 percent of all sales are residential. Firestone (1951) found 62 percent of all property transfers to be residential, while Rosenbluth (1976, p. 42) estimated that 75 percent of all real estate commission income in B.C. had a residential source. All of these findings become more credible if it is remembered that households are numerous—more than 9 million. Of these, more than 5 million own rather than rent accommodation. Households are small, i.e., have no in-house staff to handle property transfers. They are unsophisticated in property selling and transfer techniques and technology, in part due to infrequency of transactions. Few households appear to be willing or able to

sell their homes without the assistance of a real estate agent; less than 15 percent, and even as few as 7 percent, sell by owner (Islam and Jenkins 1985, p. 2; Islam 1985, p. 264).

The domination of the residential client in real estate brokerage is indirectly corroborated by noting the actual employment of real estate salespersons by real estate operators (SIC 737) and construction firms as in-house employees. According to the 1981 census, there were 20,185 real estate salespersons (5172s) employed by real estate operators and about 3,000 employed in construction and related sectors, compared to 36,530 in real estate brokerage. Hence it would seem that while some, especially small, businesses do use real estate agents, most use in-house employees. Households would therefore appear to be the main consumer of real estate brokerage services.

REGIONAL DISTRIBUTION OF OUTPUT

According to recent MLS residential surveys, there is considerable variation across provinces in both total (table 2) and per-homeowner MLS sales.

Table 2
Residential MLS for Canada, Unit Sales

	1986	1985	1984	1983	1982	1981
British Columbia	46,181	43,526	30,955	32,131	25,040	18,625
Alberta	23,705	28,162	19,028	16,124	14,680	22,722
Saskatchewan	8,211	7,850	7,046	6,667	6,255	6,727
Manitoba	11,956	11,315	9,362	9,053	6,710	6,843
Ontario	144,082	131,902	101,465	99,366	79,051	84,544
Quebec	29,203	26,238	19,959	9,624	15,474	16,737
New Brunswick	2,706	2,647	2,082	2,106	1,865	1,621
Nova Scotia	6,098	5,262	3,992	4,033	2,944	2,359
Prince Edward Island	467	536	295	427	354	152
Newfoundland	1,846	1,768	1,513	1,460	1,027	656
Yukon	178	154	110	112	59	40
Canada	274,633	259,360	195,807	181,103	153,459	161,026

For example, in 1985 there were 259,360 residential sales in Canada. Ontario had 50.8 percent of these sales, but only 36.6 percent of all owned and occupied dwellings. At the other extreme, Quebec had only 10.1 percent of sales, but 22.5 percent of dwellings. Provinces with disproportionately high

MLS sales included Alberta and B.C.; Manitoba had about equal MLS sales and dwelling shares; and Saskatchewan and the Atlantic provinces had disproportionately small MLS sales.

This pattern is confirmed by an examination of provincial employment shares for real estate salespersons (occupational code 5172) reported in the 1981 census and CREA membership data. It is also confirmed that inter-provincial disproportionality between MLS sales (or employment shares for 5172 or CREA membership) and owned and occupied housing stock is statistically significant.[3]

Regional differences in real estate brokerage activity have a number of possible explanations. Since MLS sales are only possible where a local real estate board (REB) is organized, typically in a medium to large city, it is to be expected that MLS sales in particular, and possibly housing resales in general, will be less frequently observed in unorganized areas. Examples of such areas are the Atlantic provinces, Saskatchewan, and possibly Quebec, where population is less urbanized. In addition, provinces which are less urbanized conceivably have lower per capita incomes, hence lower time costs of search and more frequent sales by owners. Given lower housing prices, less need for filtering up from starter to executive homes, and lower expected rates of job mobility, they would also have lower rates of property transfer. Such rural areas accordingly generate fewer housing resales, especially those involving the MLS and real estate agents in general, since ELS and sale-by-owner methods are more cost-effective in small rural markets.

SEASONALITY

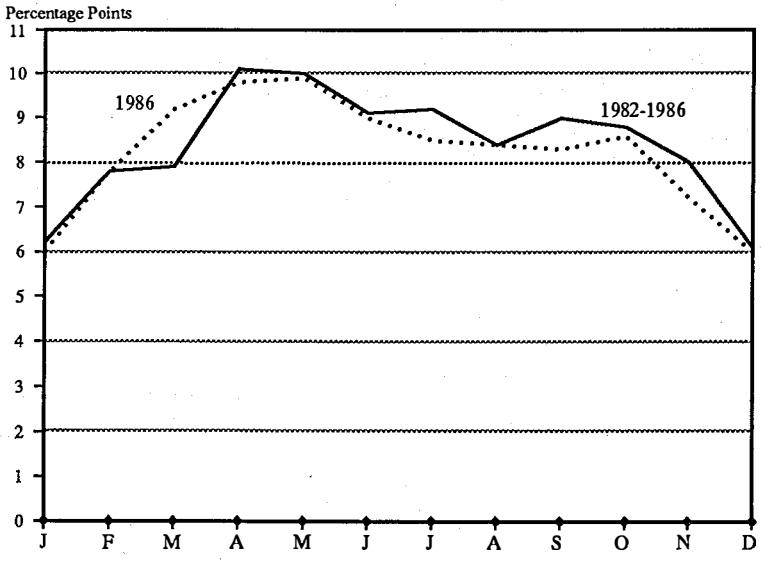
According to recent MLS sales summaries, there emerges a consistent pattern of seasonality in MLS activity, with a peak in the spring (April-May) and a trough in early winter (December-January)—see table 3 and figure 6 below.

Table 3
Average Monthly MLS Sales
Percent of Yearly Total, 1980-85 Average

JAN	FEB	MAR	APR	MAY	JUN	JUL	AUG	SEP	OCT	NOV	DEC
5.7	7.5	9.1	9.6	9.7	9.0	8.9	8.8	8.6	8.8	8.0	6.3

Although differences in monthly shares are not statistically significant,[4] there is strong *a priori* reason for viewing the differences as being systematic rather than random. Clearly considerable moving activity, with related real estate sales activity leading by, say, two months, is concentrated in the summer months in order to avoid disruption of schooling.

Figure 6
Seasonality of Sales for Residential Units



Seasonality may be even more pronounced if even more disproportionate use of ELS sales is concentrated in the same spring and summer periods of intense home sales activity.

NOTES

1. "Report on Market Share," 1986, p. 35; Sinclair 1987b.
2. The trend for SIC 9 was uncharted, as it was very close to that of SIC 9:03.
3. At the 5 percent level using a chi-squared contingency test with 9 degrees of freedom.
4. Using a chi-squared contingency test at very modest levels of significance, such as 50 percent.

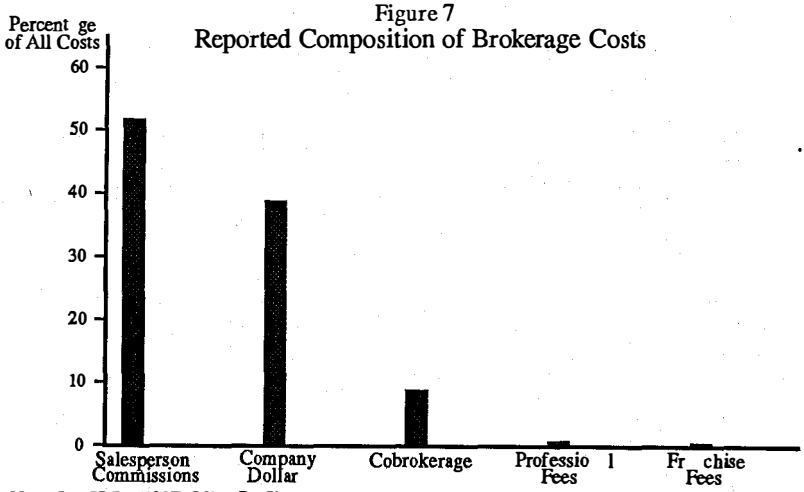
CHAPTER 4

INDUSTRY EMPLOYMENT AND PRODUCTIVITY: LEVELS AND TRENDS

EXPENDITURES ON INPUTS

Estimates of the relative values of the various categories of expenditures on inputs can be derived from two recent surveys of Canadian Real Estate Association (CREA) member offices.[1] However, these are misleading in that the individual salesperson acts as a subcontractor, and other firms act as cobrokers. Hence a complete decomposition of expenditures into basic categories (wages and salaries, occupancy, advertising, travel, and so on), on the sole basis of these data sources is impossible. Fortunately, another study provides a breakdown of the expenses of typical salespersons,[2] while a further study specifically examines the level of combined company and salesperson advertising and promotion outlays.[3]

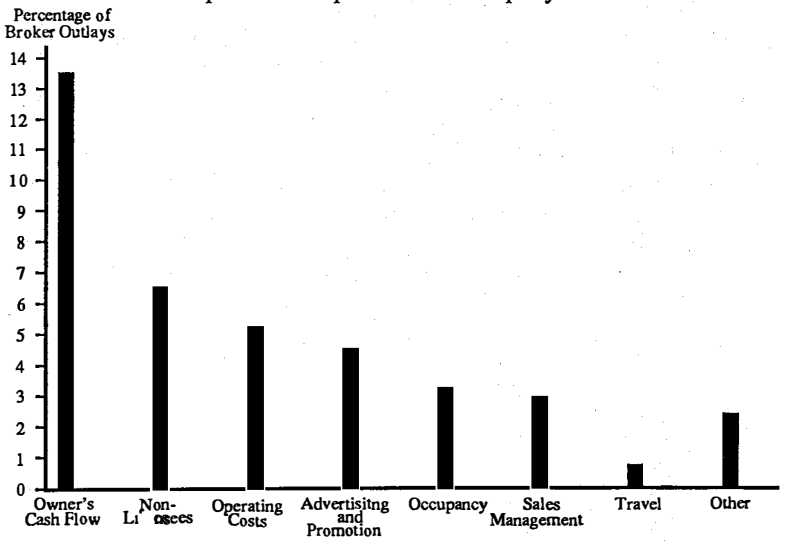
Figure 7
Reported Composition of Brokerage Costs



Note: See CREA (1987) Office Profile.

The gross income of the average CREA office during 1986 was absorbed by five classes of expenditures, as presented in figure 7. Expenditures were as follows: salesperson commission shares 51.6 percent; co-brokerage commission shares and MLS fees 8.7 percent; professional fees paid to lawyers and accountants 0.6 percent; franchise fees 0.4 percent; and "company dollar" 38.7 percent. The last of these is further decomposed in figure 8 to eight types of company disbursements. They are as follows for 1986: owner's cash flow 13.5 percent; non-licensee (primarily clerical) personnel 6.5 percent; operating costs 5.2 percent; advertising and sales promotion 4.5 percent; occupancy 3.2 percent; sales management 2.9 percent; travel 0.7 percent; and other 5.2 percent.

Figure 8
Reported Composition of Company Dollar



Note: See CREA (1987) Office Profile. Company dollar represented 38.7 percent of all brokerage outlays.

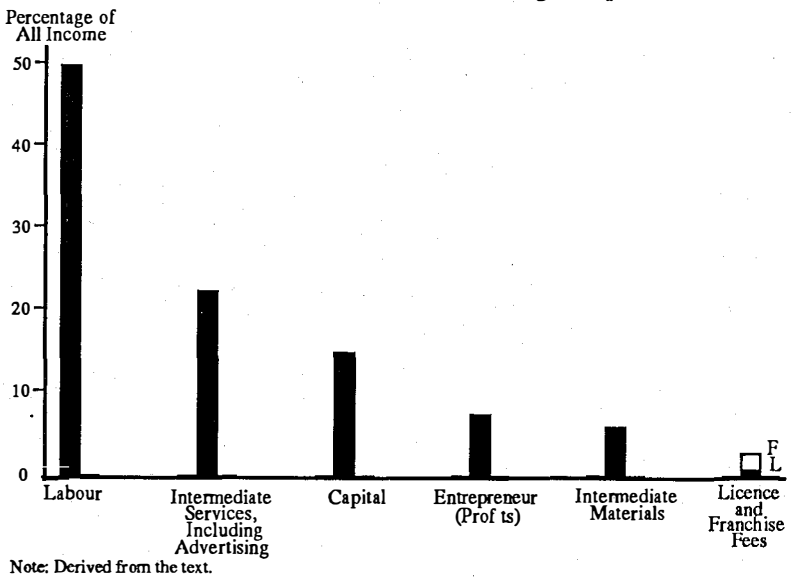
Salesperson and co-broker commission shares of 60.3 percent were partly expended by the individuals on additional expenses: automobile 6.4 percent; advertising 1.7 percent; and other 3.5 percent.

Combined company, salesperson, and co-broker expenditures on advertising and sales promotion are undoubtedly much larger than 4.5 percent of all gross income. In particular, company involvement in advertising decreased but salesperson involvement increased substantially between 1978 and 1987. The CREA (1978b) study found that company advertising

and promotion expenses alone were about 10 percent of all gross income, compared to only 4.5 percent in the 1987 study. Offsettingly, the growth of full-commission companies such as Re/Max has resulted in individual salespersons expending much more of their commissions on newspaper advertisements and mail solicitations, both to attract listings and to attract home buyers. By way of corroboration, Islam (1985, table 5.1) found that brokers expended about 8 percent of gross income on advertising and sales promotion in the Edmonton resale housing market during 1979.

Figure 9 summarizes the estimated composition of all brokerage costs—combined salesperson, company, and co-brokerage. Detailed derivation is provided in the next six subsections.

Figure 9
Estimated Factor Shares of Brokerage Output



Note: Derived from the text.

Labour Intensity

According to the CREA *1987 Office Profile*, about 6.5 percent of all expenses were for non-licensee, mostly clerical, personnel; 2.9 percent for sales management; and an estimated 31 percent for the time of own salespersons, or about three-fifths[4] of their 51.6 percent share of all expenses. Owners' labour inputs are calculated as the difference between owners' cash flow and owners' profit rate—about 13.5 minus 8.0, or 5.5 percent of all expenses, according to recent Statistics Canada *Corporation Financial Statistics.*

Hence expenditures on own labour constitute about 46 percent of all expenses. To these are added the same fraction of co-brokerage expenditures, i.e., 0.46 x 8.7 percent of all expenses, or 4.0 percent. Total expenditures on own and co-brokerage labour are therefore about 50 percent of all expenses, including owners' labour inputs.

The estimated labour-output ratio for real estate brokerage, 50 percent, compares favourably with the ratio of wages and salaries to total income given in 1983-84 *Corporation Financial Statistics*, about 50 percent for Standard Industrial Classification (SIC) 735 (combined real estate and insurance agencies). Both estimates of labour intensity are above those for all services (31 percent) and all industries (16 percent). Hence real estate brokerage is, not surprisingly, a very labour-intensive industry.

Intermediate Material Inputs

These would consist largely of company and salesperson office supplies and automobile fuel (utilities are treated below as services, although they have a material dimension). Company, and arguably combined company and salesperson, office supplies are about 3 percent of all expenses.[5] Automobile fuel expenses are unreported, but are arguably a minor portion of all company expenses—perhaps one-quarter of the reported 4 percent value for automobile expenses, i.e., 1 percent. They are undoubtedly a much larger portion of salesperson expenses, perhaps 4 to 5 percent of commission revenues. Hence automobile fuel expenses would be about 3 percent of combined company and salesperson expenses. Intermediate material inputs would therefore be about 6 percent of all real estate brokerage expenses. Hence real estate brokerage is much less materials-intensive than the entire service sector (17 percent) and all industries (50 percent).

Intermediate Service Inputs

These would include advertising and promotion, legal and accounting, computing, insurance, postage, and utilities such as telephone/communications, heat, light, and water. As discussed in chapter 4, advertising and promotion expenses are at least 4.5 percent and perhaps as much as 8 to 10 percent of all expenses after including salespersons', rather than just the company's, outlays. Legal and accounting expenses are an estimated 2 percent of all expenses (CREA 1978b, table 3). Postage is less than 1 percent, while utilities are an estimated 10 percent—6 percent for communications and 4 percent for heat, light, and water. Computing services outlays are unreported, but these are thought to be minimal. Given the popularity of individually owned and operated microcomputers, and the provision of

low-cost, centralized computer listing services by the local real estate board (REB), they are probably less than 1 percent, inclusive of access fees.[6] Hence intermediate service inputs would be perhaps 20 to 25 percent of all expenses, a value which is believed to be higher than for all services and all industries in view of the inherent advertising and communications intensity of real estate brokerage.

Capital Inputs

These would appear to be modest. Company occupancy expense, less estimated utilities, would be about 6 percent of company expenses.[7] Assuming salespersons set aside part of their residence as a personal office, with an expense equivalent to 3 percent of annual income, total occupancy expense might be about 4 percent of all expenses. Equipment outlays for company's and salespersons' typewriters, microcomputers, terminals, and communications equipment are at least 1 percent of all expenses.[8] Automobile depreciation would be about 2 percent of company expenses[9] and perhaps 10 percent of salesperson commissions,[10] or about 7 percent of all expenses. Interest expenses are about 2 or 3 percent of all expenses.[11] Hence total capital inputs would be about 15 percent of all expenses. This value is greater than that for corporate SIC 735 (8 percent), and slightly higher than for the entire corporate service sector (12 percent) and all industries (14 percent). These results can be reconciled with reported corporate capital-to-income ratios, excluding salespersons' capital inputs, for SIC 735, services, and all industries—0.5, 0.6, and 1.0 respectively (1982-84). First add to SIC 735 capital values those arising from the extensive use by real estate salespersons of their own highly depreciable late-model automobiles, communications and computer equipment, home-based offices, and other capital inputs. Then it is conceivable that real estate brokerage is more capital-intensive than all services, and as capital-intensive as all industry.

Licensing and Franchise Fees

These appear to be minimal. The former constitute about 2 percent of company expenditures (CREA 1978, table 3.8), and the latter about 0.4 percent of company expenditures (CREA 1987, p. 1) for all offices, or an estimated 2.2 percent for franchised offices only.[12] Another source, the Edmonton REB, suggests that license fees are currently (1987) much smaller: an annual registration fee of $25 for salespersons and $100 for brokers; an annual membership fee per salesperson of $140 and per broker of $365; and one-time/initial education/entrance fees of $245 for salespersons and $2,000 for brokers. Hence the typical office (according to CREA 1987) would expend only 0.3 percent of total income/expenses on annual license

and membership fees.[13] A typical *franchised* office would expend a total of about 2.6 percent on combined licensing, entrance, and franchise fees.

Profits

As pointed out in the CREA *1987 Office Profile*, owner's cash flow represents about 13.5 percent of all gross commission revenues. However, at least one-half of this represents an implicit payment to the owner for own labour inputs, since before-tax profits on total income are estimated to be in the 7 to 8 percent range (Statistics Canada, *Corporation Financial Statistics*, 1982-84). Before-tax profits correspondingly are about 15 percent of capital and 21 percent of equity, rates which are well above those for all finance (2 and 4 percent), services (10 and 18 percent) and all industries (5 and 9 percent). Since these ratios appear to be no more unstable over time than those for other industries/sectors, real estate (and insurance) brokerage would seem to enjoy above-average profitability without greater risk. The persistence of supernormal profit levels seems rather surprising in view of apparently easy entry conditions. Adding human capital to equity would probably reduce profit rates very little, as educational requirements are minimal and only two years typically elapse prior to attaining peak earnings (CREA 1976a, p. 31). Nor does it seem likely that inclusion of advertising capital in equity would reduce profit rates, since advertising expenses are already deducted from profits. It seems more plausible that a combination of industry concentration, insulation from foreign competition, institutional inertia (REBs and the MLS (Multiple Listing Service) monopoly), commission rate rigidity, and "branding" by large brokers explains the persistence of supernormal profitability in real estate brokerage.

PRICES AND PERFORMANCE OF SERVICES SOLD

Using a simplifying assumption that the typical MLS sale involved a maximum commission rate of 7 percent, together with Consumer Price Index (CPI)-inflated values of the average prices of properties sold through the MLS, the nominal and constant-dollar (real) commission per property sold for representative years is portrayed in table 4.

The brokerage costs per MLS property sold increased at nominal and real annual rates of 9.0 and 4.1 percent respectively between 1961 and 1976. Thereafter, nominal commissions continued to increase at an average annual rate of 6.3 percent, while real commissions declined at an annual rate of at least 1.3 percent. Indeed, real commissions may have declined even more rapidly from 1976 to 1986, since the average commission rate on western Canadian homes in 1986 fell below the 7 percent maximum as more house prices rose above $100,000. In addition, it appears that speed of

matches through the MLS, as measured by the sales-to-listings ratio, has remained relatively constant over time.[14] Real commissions may have risen in response to the increasing complexity of urban housing markets, but computerization and increased sales per salesperson detract from such an explanation. Hence the increase in real brokerage costs over the period 1961-86 may be partly the outcome of market power rather than faster speed of matches or increased product complexity alone.

Table 4
Nominal and Real Commissions per MLS Sale

Year	Nominal Commission	Real Commission (1986 dollars)
1961	$ 989	$4,138
1966	1,228	4,610
1971	1,721	5,397
1976	3,595	7,567
1981	5,516	7,303
1986	6,643	6,643

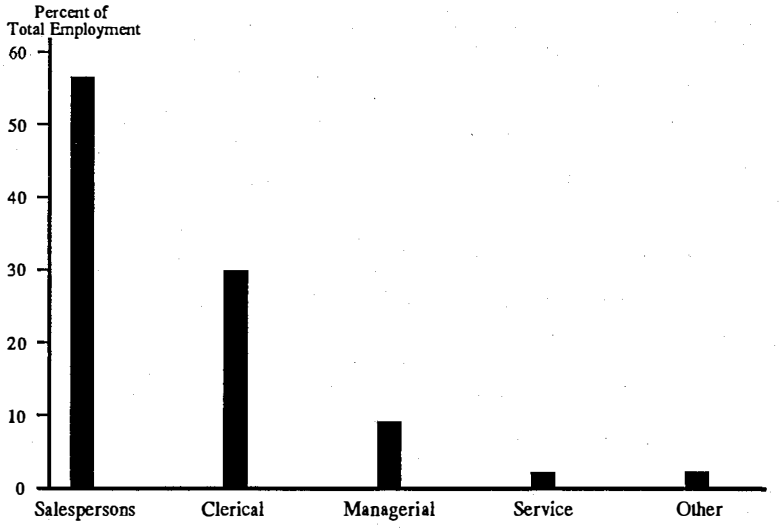
The related rigidity of the commission formula prior to 1976, in spite of rising real property values, is thought to reflect the pre-1976 ability of local REBs to fix prices. Post-1976 commission-formula constancy is seen as a consequence of the post-1976 "structural" phenomena: institutional inertia (as reflected in the continuation of east-west formula differences); increasing concentration; and growing branding effects in real estate brokerage. The only apparent exception involves the modest recent erosion of real commission rates in western Canada, which has arisen from the escalation of more house prices above the $100,000 break point.

CHARACTERISTICS OF THE LABOUR FORCE

Number of Employees

Of the 115,330 workers in combined real estate and insurance agencies (SIC 735) reported in the 1981 census, it is estimated that about 63 percent, or 73,000, were employed in real estate brokerage.[15] Figure 10 provides a further breakdown of real estate agency (REA) employees into salesperson, clerical, management, and other categories. In many cases, managers are thought to do double duty as salespersons, so salespersons probably repre-

Figure 10
Composition of Real Estate Brokerage Employment



Source: 1981 Census: Population - Occupation and Industry.

sent well over 60 percent of all employment, a finding which may be conservative in view of the recent CREA *1987 Office Profile*.[16]

In terms of time trends, 1971-1981, the proportion of sales personnel increased by 3 percent; that of clerical personnel decreased by 5 percent; and that of managerial personnel increased by 2 percent. Hence there would appear to be a trend in real estate (and insurance) brokerage to economize on clerical personnel by using more word processors and computers. It is also possible that sales and managerial personnel may be able to perform some clerical functions using new technology, but the Edmonton Real Estate Board suggests that this is uncommon.

As for the educational background of real estate salespersons (occupational code 5172), the 1981 census reveals the most common educational background to be "trades, university or other non-university certificate or diploma." However, this undoubtedly reflects little more than the completion by most salespersons of a high school diploma, or less, plus the prelicensing and other occupationally related courses. This being the case, it is estimated that about one-third of all salespersons have completed some, but not all, high school; about one-third have completed high school; about one-sixth have a community/junior college/trade certificate; and the remaining one-sixth have a university degree. Only a small proportion, 3 percent, have no high school, typically older salespersons, 45 to 64 years

old. Male and female salespersons appear to be about equally well-educated, while younger workers (25 to 44) are better educated than older workers. Real estate persons are thus, on average, only slightly better educated than other workers, who typically have a high school diploma only.

In terms of experience levels, it is anticipated that real estate salespersons and brokers have lower than average experience than other workers for several reasons. First, the annual rate of growth of total census employment of real estate salespersons (class 5172) has exceeded that for all occupations. For class 5172, annual growth rates were 7.0 and 10.0 percent during 1961-71 and 1971-81 respectively, corresponding to an estimated maximum average experience level of 7.8 years. For all occupations, annual growth rates were 2.9 and 3.3 percent respectively, corresponding to an estimated maximum average experience level of 16.2 years.[17]

Second, there appears to have been substantial turnover[18] in real estate brokerage, as noted by Rosenbluth (1976, tables 6c and 14) for B.C., 1965-75. Only about 80 percent of licensees renewed annually, while a further 20 percent were new licensees and 8 percent were re-entrants. The observed median experience level in 1975/76 was about 4 years. The minimal data available for other provinces and periods[19] indicate similar turnover rates and hence experience levels. Interfirm mobility within the same industry has been observed to be quite high in other industries (Economic Council of Canada 1976), with annual retention rates varying from 60 percent in mining to over 90 percent in utilities. However, it is believed that easy entry, and often spectacularly high but frequently inaccessible individual earnings levels, lead to lower industry and occupation retention rates,[20] and lower experience levels, in real estate brokerage.

Third, Rosenbluth (1976, pp. 17-21) notes the tendency of many workers to undertake real estate sales as a second career. He observed a median age of entry of 41 to 45 in B.C. during 1974/75. He also observed a median age class among established real estate salespersons of 51 to 55, and noted a similar pattern in the U.S. Hence careers in real estate brokerage tend to start later and be shorter than in other occupations. A similar pattern, albeit less extreme, is observed in the 1971 census, where the median age class was 45 to 49 for real estate salespersons, compared to 35 to 39 for all occupations. However, this pattern may be changing toward a younger real estate sales force, in both absolute and relative terms. In the 1981 census, the median age of real estate salespersons was 41.4, compared to 45.8 in 1971; i.e., there was an implicit decline of 4.4 years. In contrast, the median age in all occupations fell to 33.7 from 36 in 1971, a decline of only 2.3 years. Hence real estate brokerage is becoming more often a first rather than a second career.

Unionization

It would seem that there is little or no unionization in the real estate brokerage industry. This is not surprising in view of the fact that at least two-thirds, and possibly even 85 percent, of workers are licensed professionals in the managerial or commission-sales categories. Moreover, most other workers are clerical and they are typically secondary, part-time, or isolated—an average of only two per office. Such workers evidence a traditional reluctance to become involved in unions. This pattern is only slightly more pronounced than for the rest of the finance, insurance, and real estate industry, where only 2.5 percent of the work force was organized in 1983 (Corporations and Labour Unions Returns Act).[21]

Training Facilities

The contents of both pre-licensing courses and examinations for salespersons and brokers are directly, or at least ultimately, under the control of the provincial governments.[22] However, there appears to be a longstanding practice of delegating the administration of courses and examinations to the provincial real estate associations. These, in turn, permit input and cooperation from the local real estate boards. Basic instruction is typically through correspondence courses, usually over a span of a few months for prospective salespersons and up to a year for brokers. Increasingly, provincial associations and local boards arrange, and even require, classroom attendance. B.C. now requires a two-year post-secondary programme at the University of British Columbia or a community college for broker candidates. Salesperson candidates must be sponsored by an established broker, while broker candidates typically require a year or two of prior experience as a licensed salesperson. Small bonding requirements usually pertain to salespersons and larger ones to brokers. Rosenbluth (1976, pp. 71-74) provides a critique of B.C.'s training programmes in the mid-1970s, and remarks that salesperson and broker programmes should be equalized by respective lengthening and shortening.

Continuing education, following successful completion of pre-licensing courses and exams, appears to be on the increase. Courses are offered by provincial associations or local boards, sometimes in conjunction with post-secondary institutions. They typically address certain narrower types of real estate transactions such as commercial or rural real estate and property management. There appears to be some move to make continuing education compulsory. However, it has been "grandfathered" in at least one case; e.g., salespersons in the Edmonton REB having less, not more, than 10 years experience must complete a three-year refresher course. Such a strategy may be little more than a thinly disguised attempt to escalate effec-

tive entry requirements. There appears to be no move to introduce preferred or licensed specialties in real estate brokerage.

The Role of the Entrepreneur

Individual salespersons can readily move between brokers—perhaps too readily from the vantage point of the traditional 50-50 brokers who lose many top salespersons to the full commission brokers. Salespersons work on a subcontract equivalent split (50-50)- or full (95 to 100 percent)-commission basis. In the case of the full-commission brokers, salespersons actually pay for overheads ($1,000 to $1,300 monthly). Hence salespersons are quasi entrepreneurs. Since over 60 percent of all brokers are single-office entities, often with less than six salespersons, the broker exercises his entrepreneurial prerogatives without any separation of ownership from control. Even Royal LePage seems to have remained a largely privately held corporation, and therefore its owners need fear little potential deviation from profit maximization by its managerial staff.

Coverage by Statistical Surveys

As indicated earlier, a major source of data for real estate brokerage employment is the decennial census, albeit only for 1981 does it provide a direct allocation of detailed occupational classes to SIC 735.[23] It provides information on the employment, earnings, and education of real estate salespersons (class 5172). However, it fails to distinguish between the earnings, education, and employment of class 5172 workers engaged by real estate agencies as opposed to real estate operators (SIC 737) and other industries.

Another government survey also fails to distinguish between real estate and insurance agency employment. The monthly Statistics Canada publication *Employment, Earnings and Hours* reports employment, average weekly earnings, and hours for SIC 735. It even distinguishes between salaried, hourly-rated and commission personnel. However, it canvassed only large firms[24] prior to March 1983; hence it excluded a large number of brokers from the sample. Since that time, it samples all brokerage size classes, but does not report data for SIC 735 in the case of the smaller provinces.

Other government data sources include the annual reports and other records generated by provincial Superintendents of Real Estate. These provide data on any or all of total salesperson and broker registrations, renewals, and lapses. However, they are incomplete to the extent that some provinces are willing to provide only recent data, while others are unwilling to provide any data.

Private sources of data are reported by Rosenbluth (1976, footnotes) and Islam (1985, bibliography). In addition, CREA periodically undertakes updates on its membership data, as well as occasional studies such as the *1975 Real Estate Earnings Survey, Canada*; *Trends in the Distribution of Real Estate Earnings in Canada, 1970-75*; *The Real Estate Profession in Canada* (1976); *Real Estate Brokerage Firms, Income and Expenses* 1978; *The Real Estate Vocation in Canada* (1978); and the *1987 Office Profile.* However, data are unreported for some years and encompass only CREA members.[25] Data also typically refrain from canvassing and reporting salesperson earnings net of expenses.

PRODUCTIVITY OF THE LABOUR FORCE

A number of difficulties encumber attempts to measure the level and trends of labour productivity in real estate brokerage. The general failure of Statistics Canada to disaggregate the output and employment of real estate agencies from insurance agencies, and even real estate operators, is most obvious. Another is the difficulty of measuring output: should output be measured as the number of units sold, the value of those units, the value of commissions, value added, or what? A related problem is the variability of quality across regions and over time. For example, are matches between buyers and sellers homogeneous, or is this even possible given the heterogeneity of property types and of seller and buyer characteristics?

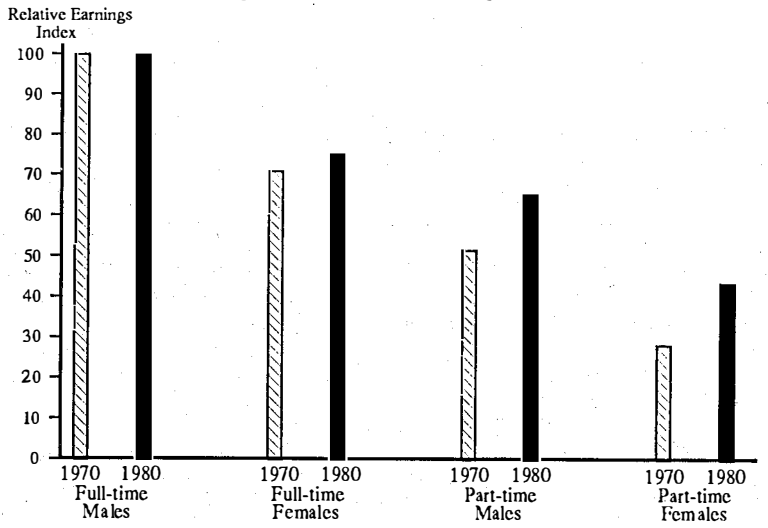
A further problem arises in terms of measuring the labour input. Real estate salespersons are quite heterogeneous in terms of the proportion of full-time to part-time workers and, in fact, even full-time workers may be heterogeneous in terms of time and other resource inputs.[26] Moreover, to what extent are other types of labour (e.g., clerical) and other inputs (e.g., computers) used as substitutes[27] for the services of real estate salespersons? These and other problems are only partially resolved in an attempt to measure the level and trends in labour productivity in real estate brokerage.

The number of real estate salespersons (class 5172) employed in real estate brokerage[28] grew from an estimated 16,640 in 1971 to a reported 36,530 in 1981 (according to the census). However, both of these values are less than those derived from other sources reporting employment of real estate salespersons during this period. CREA membership was roughly one-third higher than the census employment values during the 1971-81 period, even though not all real estate salespersons are CREA members. This is probably because CREA membership also includes real estate brokers and managers, as well as some members working in government, real estate operations, and local REB offices. Provincial registrations were even greater, typically three-quarters more than census employment. Conceivably many provincial registrants maintain their licenses,[29] even though not

actively employed in the real estate brokerage industry. The employment of real estate salespersons is probably somewhere between the census and CREA values.

A further problem arises in that male and female, and full-time, full-year and part-time 5172s have different average earnings and related time inputs. Figure 11 shows the relative earnings of alternative groups in relation to a full-time, full-year male-equivalent for 1970 and 1980 respectively. Employment of females and part-time workers increased more rapidly than that of both real estate salespersons in general, and full-time, full-year males in particular. Hence it is not surprising that, while employment of all 5172s grew by 158 percent over the period 1971-81, employment of full-time male equivalents (FTMEs) grew by only 132 percent.[30] Hence, productivity as measured by output per employee, ignoring sex and full/part-time status, would understate productivity as more appropriately measured by output per FTME in both level and trend.[31]

Figure 11
Real Estate Salesperson Relative Earnings Indices, 1970 and 1980



Source: 1981 Census: Population - Income.
Note: Full-time male earnings were normalized to 100 in 1970 and 1980.

Another problem that arises in measuring the level and trend of output per worker is the cyclical nature of real estate brokerage. Total sales, total employees, and average sales per employee can vary dramatically from year to year. Hence a moving-average approach to measuring productivity becomes necessary.

Table 5
MLS Unit Sales and CREA Membership

Year	MLS Sales (1)	CREA Members (2)	MLS Sales per Member (3) = (1)/(2)
1970	70,619	25,556	2.8
1971	86,185	27,032	3.2
1972	94,285	29,848	3.2
1973	107,123	35,335	3.0
1974	111,163	39,851	2.8
1975	145,163	42,815	3.4
1976	142,040	45,869	3.1
1977	161,110	48,528	3.3
1982	174,536	50,145	3.5
1983	209,314	50,608	4.1
1984	221,218	57,293	3.9
1985	293,256	62,047	4.7
1986	311,021	67,630	4.6

Sources: CREA (1985–86) and CREA membership records.

Note: Column 2 includes dual memberships for 1970–78, about 1 percent of total. The value for 1982 was estimated.

An obvious and readily available measure of labour productivity in real estate brokerage is annual unit MLS sales per CREA member. Available data for the 1970s and 1980s are presented in table 5.

For the biennial periods 1972-76 and 1982-86,[32] unit sales per CREA member were about 3.0 and 4.0 respectively, implying a crudely measured productivity increase of about one-third. However, unit MLS sales understate all broker sales, while CREA membership misstates the number of full-time male equivalent (FTME) real estate salespersons. Hence MLS sales per CREA member misstates "true" labour productivity as reflected in unit sales per FTME salesperson.

As indicated in table 6, MLS unit residential sales[33] considerably understate all residential sales—the sum of broker sales, whether MLS or ELS (Exclusive Listing Service), and sales by owners. The latter were primarily derived from Statistics Canada family expenditure surveys and estimates of the owned housing stock. If it is assumed that MLS unit non-residential sales similarly understate all non-residential sales, the reported MLS unit sales can be first adjusted upward to provide estimates of all sales, and then

Table 6
Estimated MLS and Total Residential Unit Sales

Year	MLS (1)	Total (2)	MLS/Total (3) = (1)/(2)
1970	60,708	85,288	0.71
1971	74,090	104,087	0.71
1972	81,054	115,898	0.70
1974	95,563	162,384	0.59
1976	122,107	140,962	0.87
1982	151,299	167,217	0.91
1984	194,842	211,157	0.92
1986	274,633	339,285	0.81

Sources: CREA, *Annual Statistical Survey, MLS*; Statistics Canada, *Family Expenditure, Household Facilities and Equipment*; Financial Times News Service 1987; and Sinclair 1987a.

Table 7
Estimated MLS and Total Broker Sales

Year	MLS Sales (1)	MLS/Total (2)	All Sales (3) = (1)/(2)	Broker Sales (4) = (3)x0.93
1970	70,619	0.71	99,463	92,500
1971	86,185	0.71	121,387	112,890
1972	94,285	0.70	134,692	125,264
1974	111,163	0.59	188,411	175,223
1976	142,040	0.87	163,264	151,835
1978	173,678	0.73	237,915	221,261
1982	174,536	0.91	191,798	178,372
1984	221,218	0.92	240,454	223,623
1986	311,021	0.81	383,976	357,098

reduced by roughly 7 percent sales-by-owner to yield estimates of all broker sales per table 7.

CREA membership misstates the total number of FTME real estate salespersons for two major reasons. First, CREA members constituted only 77 percent of all registered brokers and salespersons (1973-77). Second, not all real estate salespersons, and, arguably, not all CREA members, were FTME salespersons, since the census indicates that the number of FTME salespersons was only 83 and 67 percent of that of all salespersons in 1970

and 1980 respectively. Table 8 provides estimates of the number of FTME real estate salespersons (column 3) during the 1970s and 1980s, incorporat-

Table 8
CREA Members and FTME Salespersons

Year	CREA Members (1)	FTME/All Salespersons (2)	FTME Salespersons (3)=(1)x(2)/0.77
1970	25,556	0.83	27,547
1971	27,032	0.81	28,436
1972	29,848	0.80	31,127
1973	35,335	0.78	35,794
1974	39,851	0.76	39,437
1975	42,815	0.75	41,703
1976	45,869	0.73	43,486
1977	48,528	0.72	45,377
1982	50,145	0.64	41,803
1983	50,608	0.63	41,295
1984	57,293	0.61	45,760
1985	62,047	0.60	48,510
1986	67,630	0.59	51,733

Sources: CREA membership records and imputations from the 1971 and 1981 census.

Table 9
Broker Sales per FTME Salesperson

Year	Broker Sales (1)	FTME Salespersons (2)	Broker Sales/FTME Salespersons (3)=(1)/(2)
1972	125,264	31,127	4.0
1974	175,223	39,437	4.4
1976	151,835	43,486	3.5
1982	178,372	41,803	4.3
1984	223,623	45,760	4.9
1986	357,098	51,733	6.9

ing a constant 77-percent participation of salespersons in the CREA and the secular decline in full-time male-equivalency over the entire period.

Combining the results of table 7, column 4 and table 8, column 3, for selected years, biennially 1972-76 and 1982-86, along with quotients, gives the productivity measures of table 9, column 3.

Productivity, as measured by broker sales per FTME salesperson, increased by about one-third between 1972-76 and 1982-86, i.e., from 4.0 to 5.4 unit sales per FTME per annum. Coincidentally, this compares with the similar increase in productivity as measured by MLS unit sales per CREA member. In either case, real estate brokerage productivity rose at about 3 percent annually between the 1970s and 1980s, a rate about double that for the economy as a whole.[34] Perhaps real estate brokerage has taken greater advantage of new computer technology.

Results are unaffected by changes in the quality of output, as real property price and sales-to-listing ratios[35] remained more or less secularly stable over the past two decades. Since there was modest net substitution for clerical personnel between 1970 and 1980 (according to the census), productivity per salesperson is modestly understated. Modest secular changes in CREA participation (from 77 percent) or sales by owners (from 7 percent) have little impact on productivity changes. Finally, if the secular average of full-time male-equivalency is held constant at 0.67 after 1980, annual productivity growth falls from about 3 percent to 2 percent, but is still above economy-wide levels.

There is considerable variation among real estate brokers in productivity. For example, Royal LePage reports 15 sales per salesperson in 1986 and Re/Max reports 18 to 37, compared to industry averages of about 5.[36] This suggests some potential for industry rationalization, especially if there indeed is any excess capacity in the form of unproductive or underemployed salespersons (and related high rates of labour turnover), and if a significant amount of salesperson time devoted to the solicitation of listings is rivalrously offsetting. Appropriate government policy could generate further productivity gains. As is discussed in the concluding chapter, competition might be fostered through scrutiny and, where appropriate, opposition by the Competition Tribunal to further large-broker mergers, as well as through continued investigation of possible price fixing and advertising restrictions. More vigorous competition may yet lead to a readily measurable benefit to consumers from productivity gains in the form of lower commissions or faster sales. In the long term, its absence, and the related perseverance of the rigid commission formulae, may abet so much new entry as to ultimately erode even those productivity gains reflected in currently higher salesperson earnings.

NOTES

1. CREA, 1978b and 1987.
2. Rosenbluth 1976, especially table 10, unfortunately for an earlier period (1974).
3. Islam 1985, especially table 5.1.
4. Rosenbluth 1976 table 10 suggests a value of four-fifths, but, according to the Edmonton Real Estate Board (Art Jones, 1987), three-fifths is more appropriate today.
5. CREA 1978b, table 3.8.
6 Access fees to the Edmonton REB service averaged only $85 per annum per salesperson in 1987.
7. CREA 1987, p. 1; Statistics Canada, *Corporation Financial Statistics*, 1983-84.
8. CREA 1978b, table 3.8.
9. About one-half of the 4 percent automobile expenses reported in CREA 1978b, table 3.8.
10. Comparing estimated annual depreciation on a late-model, full-size car with salesperson earnings.
11. Statistics Canada, *Corporation Financial Statistics*, 1983-84.
12. Ferguson 1986 p. 43 reports franchise fees of $15,000 for five years per franchised broker, plus $70 monthly per salesperson employed. A typical office with 11.4 licensed salespersons (CREA 1987, p. 1) would therefore pay $12,576 annually in franchise fees, which is 2.2 percent of its gross revenues/expenses.
13. This would increase to 0.4 percent if an amortized portion, at 10 percent annually, of one-time entrance fees were included.
14. The quotient of monthly unit sales and the stock of listings was 39.8 percent, 1961-76, and 36.3 percent, 1976-86.
15. Since 63 percent of all salespersons in SIC 735 were real estate salespersons.
16. It found that 11.4 of 13.4 personnel, or 85 percent, in the typical office were licensees.
17. Half those employed in 1961 were assumed to have retired by 1981. All subsequent entrants between 1961-71 and 1971-81 were assumed to be still in the relevant occupational class, with entry assumed to have occurred early enough to preclude retirement before 1981.
18. Industry or occupation entry and exit rates.
19. For example, Manitoba, 1977-86, and Quebec, 1986-87.
20. Some individuals lack ability, others lack patience.
21. About 36 percent of the entire workforce was unionized.

22. Often through the Superintendent of Real Estate.
23. Unfortunately without disaggregating real estate from insurance agencies.
24. Large firms have 20 or more employees.
25. CREA membership includes about three-quarters of all licensed agents.
26. For example, some full-time agents may work 40 hours per week while others work 60 hours.
27. As opposed to complements.
28. More precisely, SIC 735, real estate and insurance agencies.
29. For a nominal annual fee of $25, a real estate salesperson employed by a real estate operator can, for example, maintain his registration.
30. Equivalent to annual growth rates of 10.0 and 8.8 percent respectively.
31. By an estimated 11 percent, or 1 percent annually.
32. These years encompassed a long enough period to mitigate the short-term volatility of MLS unit sales. They were also compatible with other data sources used below.
33. MLS residential sales were assumed to be 86 percent of all MLS sales, 1970-78.
34. Annual rates of productivity increase were calculated from Statistics Canada, *Aggregate Productivity Measures*, per man-hour, to be 1.4 percent for all industries and 1.2 percent for service industries, 1974-84.
35. Inversely related to time on market.
36. Financial Times News Service 1987; Brodle 1985; Ferguson 1986.

CHAPTER 5

SOURCES OF CHANGING DEMAND FOR REAL ESTATE BROKERAGE

There are a number of factors which have undoubtedly contributed to the rising demand for the services of real estate agents, particularly during the 1970s and 1980s. As indicated in chapter 3, the estimated annual growth rate of output for REAs between 1971 and 1981 was about 7 percent. This was well above those for all industries (4 percent) and the entire service sector (5.2 percent). Some of the factors discussed below contributed only to the growth of REA output at economy-wide rates, while others provided the impetus for excess growth.

GROWTH OF THE OWNED HOUSING STOCK

Since most transactions involving real estate brokers are residential in nature,[1] the growth of the owned housing stock has an obvious impact on the demand for real estate brokers. During the period 1961-81, Canada's owned housing stock increased by 71 percent, or by 2.7 percent annually, from 3.0 to 5.1 million. This increase is less than that for the entire owned and rented housing stock—which increased by 80 percent, or by 3.0 percent annually, from 4.5 to 8.1 million. During the shorter period 1971-81, annual growth rates for owned and total housing stocks were slightly higher, 3.4 and 3.6 percent respectively.

Growth of the owned housing stock is well below that for REAs, 3.4 percent compared to 7 percent for 1971-81. Other factors must explain the abnormally high growth of demand for real estate brokerage.

INCREASING TURNOVER OF OWNED HOUSING

As the Canadian economy has prospered and become more urbanized, there has developed a tendency toward more frequent change of residence by Canadian households. Company transfers and migration such as those to

Alberta in the 1970s and to Ontario in the mid-1980s increase turnover. More significantly, high housing prices and mortgage rates may have led to upward filtration for baby-boomers, beginning with starter homes in their 20s and ending with executive homes in their 40s. The growing involvement of established families in resales corroborates this trend (Tougas 1988). Finally, a combination of a "booming economy, the $500,000 lifetime gains exemption and some hot communications technology" is also seen by Sinclair (1987a) as increasing turnover.

The number of properties sold annually on the Multiple Listing Service (MLS) increased from about 1 percent of the owned housing stock in 1961, to 2 percent in 1971, 3 percent in 1981, and about 5 percent in 1986. A similar pattern is suggested by Statistics Canada *Family Expenditure* data and industry reports, with about 3 percent of homeowners changing residence in 1971, 4 percent in 1981, and almost 6 percent in 1986.[2] Unfortunately, the turnover data provided by these data sources is available only for certain years: 1970-72, biennially 1974-78, and biennially 1982-86. In some cases surveys involve only large urban populations and hence would conceivably overstate total turnover. However, there would nonetheless appear to be little doubt that increasing turnover alone might have nearly doubled the demand for real estate brokerage, *ceteris paribus*, over the period 1971-86.

SUBSTITUTION OF BROKERAGE FOR SALE-BY-OWNER METHODS

Unfortunately little, and sporadic, data exists on sales by owner. Islam (1985, table E.1) shows a median percentage of homes sold by owners of 10 to 15 percent in a sample of major U.S. cities (1973-74), with a range from 0 to 5 percent up to 25 to 30 percent. Islam and Jenkins (1985, p. 63) report about 7 percent of all home sales being by owner in Edmonton in the early 1980s. Hence it is difficult to quantify any trend in sales by owners, particularly a suspected downward trend.

A downward trend in sales by owners, with a corresponding upward trend in broker sales, is expected for several reasons. First, while there is little evidence of reduced real prices for brokerage services,[3] there is reason to believe that the effectiveness of brokerage methods has been enhanced by technological innovation, particularly as embodied in the computerization of the MLS during the late 1970s and 1980s. Even though sales-to-listing ratios have evidenced secular stability, it may be that homeowners receive an even better price, and buyers an even better match, for any given length of time spent by a home of given characteristics on the brokerage market.

Second, the relative costs of sale-by-owner methods have increased for several reasons. Increasing urbanization and growing size of existing large cities make sale-by-owner techniques even more time-intensive. Interurban moves, which are especially time-intensive, may be on the upswing. Hence sale-by-owner methods are even more costly, especially in relation to company-paid or tax-deductible broker methods. Increasing family incomes, especially where both spouses work, also increase the relative time costs of sale-by-owner methods. This would be especially true for the unusually large number of inexperienced, first-time homebuyers (baby-boomers) of the 1970s and 1980s (Jud 1983). Hence it is plausible that sales by owners, even as facilitated by computer listing services such as Komputermatch in Edmonton,[4] are probably increasingly replaced by broker sales.

Casual evidence would support the contention of a declining incidence of sales by owners. As shown in table 6, MLS sales grew from an estimated 72 percent of all sales in the 1970s to about 88 percent in the 1980s. Even though much of this growth may have been at the expense of ELS (Exclusive Listing Service) sales, some could reflect reduced sales by owners.

A further factor potentially encouraging the substitution of brokerage sources for sale-by-owner methods reflects the recent tendency of major brokers to package real estate brokerage and mortgage pre-approval services. Such packaging is not without precedent, as brokers of yesteryear often provided both real estate brokerage and property insurance to their clients. Recent mergers between Royal Trust and A.E. LePage, and between Canada Trust and Canada Permanent Trust,[5] have led to pre-approved mortgages for properties and pre-approved mortgage credit limits for individual buyers. Re/Max has even arranged a similar pre-approval programme for its clients with the Toronto Dominion Bank. Since such arrangements reduce the time-and-inconvenience transaction costs of home sellers and buyers, it is more likely that homeowners will transact through brokers rather than directly.

A special case of sale-by-owner arises when a real estate operator, especially a developer, maintains an in-house sales staff. Census data reveal that between 1971 and 1981 there was a considerable increase in the employment of real estate salespersons (5172s) in SIC (Standard Industrial Classification) 737. The nearly fourfold increase in employment[6] greatly exceeded the growth in real output of SIC 9:03, which less than doubled. Hence a trend toward business use of full-time in-house sales staff, rather than untrained staff or real estate brokers, is evident. Arguably the same factors encouraging the use of trained real estate salespersons, rather than owner methods, and increasing vertical integration plausibly explain the abnormally high growth of employment of 5172s by real estate operators.

REAL MORTGAGE INTEREST RATES AND REAL HOUSING PRICES

The effect of real mortgage interest rates on resale housing markets, and real estate brokerage demand in particular, is well recognized. For example, see recent discussions in (Canadian Real Estate Association) *Annual Statistical Surveys, MLS*, and general economic modelling of a negative effect in view of brokerage-mortgage complementarity in home purchases. Both first-time buyers and those trading up typically mortgage a significant portion of the entire purchase price of the acquired home. Hence the spot real mortgage interest rate has a potentially large negative impact on resale housing markets, notably the level of resale activity and use of broker services. Real housing prices would have a similar, albeit smaller, negative indirect impact on resale activity, to the extent that they interact with the real mortgage interest rate.[7] However, they would have a less-obvious direct linkage with resale housing markets in that high prices may be an *effect* of high demand, rather than a *cause* of low demand. Moreover, high real housing prices may be recouped by the buyer upon future resale and may encourage older homeowners to make capital gains by current sale and removal to rental accommodation. Finally, fluctuations in real housing prices are typically smaller in relative magnitude than those in real mortgage interest rates, and hence would have a smaller impact on resale housing activity. For example, between 1961 and 1985, real housing prices, adjusted for changes in relation to the 1971 Consumer Price Index (CPI), increased from a low of $18,845 in 1961 to a high of $34,492 in 1976, and then fell to about $30,248 in 1986.

Real mortgage interest rates varied from 5.8 percent in 1961, to 0.4 percent in 1975, to 10.2 percent in 1984, to 6.1 percent in 1986—implying a variation in monthly payments of plus or minus 45 percent about the median for a new 25-year mortgage on its first five-year term.[8] Since the real mortgage interest rate is quite volatile, much of its impact is expected to be short-term, resulting in a postponement of moving plans.

REGRESSION ANALYSIS

A partial test of the relevance of some of the above factors in explaining the use of brokerage services was conducted using a regression analysis. The natural logarithm of real Gross Domestic Product (GDP)[9] of SIC 9:03 (insurance agencies and real estate business, or IR), LGIR, was the dependent variable. Independent variables included the logarithm of the owned housing stock (in 1,000s), LOHS, and the real annual mortgage interest rate on a five-year renewal, MOR.[10] Other explanatory variables were also included initially, but were found to be statistically insignificant at the 5 percent level—the logarithm of real housing prices; total real GDP; real GDP for

insurance carriers as a proxy for the insurance brokerage component of LGIR; and the rented housing stock and real construction GDP as proxies for the real estate operator component of LGIR. Other explanatory variables were excluded due to the incompleteness of the data set—for example, housing turnover and real estate salesperson and total employment ratios for SIC 735 and 737. Regression results were as follows for the full sample period, 1961-85, and subperiods 1961-71 (low growth) and 1972-85 (high growth.)

(5.1) $LGIR = -4.59 + 1.55LOHS - 0.68MOR$
$(-21.4) \quad (59.6) \quad (-3.1)$
(1961-85) $R^2 = .994$
$DW = 1.38$

(5.2) $LGIR = -3.47 + 1.42LOHS - 1.72MOR$
$(-4.8) \quad (15.6) \quad (-2.8)$
(1961-71) $R^2 = .970$
$DW = 1.63$

(5.3) $LGIR = -6.34 + 1.76LOHS - 1.26MOR$
$(-11.7) \quad (27.1) \quad (-4.7)$
(1972-85) $R^2 = .992$
$DW = 2.39$

Although sample size is small, especially for subsamples, a high degree of statistical significance is indicated in terms of the values and T-statistics of, and interperiod differences in, coefficients for owned housing stock and real mortgage interest rates. Since the coefficient of LOHS is significantly in excess of unity, an upward trend in housing turnover involving brokers is evident. Since the coefficient of MOR is significantly negative, especially for the subperiods, real mortgage interest rates do appear to discourage real estate brokerage activity.

It would appear that increases in brokerage activity in the later period, 1972-85, were especially responsive to increasing turnover. Table 10 provides annual growth estimates for GDP in SIC 9:03 (GIR), owned housing stock (OHS), real housing prices (RHP), and the real value of the owned housing stock (RVOHS as a proxy for potential commission revenues).

Combined insurance agencies and real estate business (IR or SIC 9:03) was relatively stagnant during 1961-71, with GIR growing more slowly than RVOHS, perhaps due to low turnover. However, this pattern was

reversed in the later period, 1972-85, with GIR growing more rapidly than RVOHS, probably due to a combination of rapidly rising turnover and more frequent use of broker rather than sale-by-owner methods. It is, in fact, arguable that all the "excess" growth of GIR in relation to VOHS,[11] and real estate brokerage in relation to IR/SIC 9:03,[12] 1972-85, can be attributed to the rise in turnover.[13]

Table 10

Annual Growth Rates, Selected Variables

Period	GIR	OHS	RHP	RVOHS
1961–71	2.82	2.06	2.69	4.80
1972–85	5.38	3.10	0.59	3.71

The role of the real mortgage interest rate (MOR) is of direct interest, as discussed above. It is also of indirect interest, to the extent that it provides some indication of the role of changes in real brokerage commission rates equivalent in their impact on the cost of buying or trading homes. MOR has a coefficient of about 1.5 (from formulae 5.2 and 5.3), suggesting that a 1-percent increase in MOR (from, say, 4 to 5 percent) would reduce the demand for brokerage services (as reflected in GIR) by about 1.5 percent. A corresponding price elasticity is estimated as follows. Assume that the average home buyer, selling one home and buying another, undertakes total mortgage borrowings of, say, 50 percent of the value of the new home, and typically takes a 25-year mortgage with an initial term of five years. A 1-percent increase in the real mortgage interest rate[14] increases the anticipated cost of changing homes by 2.5 percent of the value of the new home. This implies a price elasticity for resale housing for a 1-percent increase in MOR equal to 0.6, i.e., 1.5 percent (quantity change) divided by 2.5 percent (price change). This value is consistent with observed ranges of price elasticity of demand for housing in general.

By way of contrast, a 1-percent increase in real estate brokerage commission rates from, say, 7 to 8 percent, would be equivalent to a direct increase of 1 percent in the cost of changing homes. This same cost increase could also arise from a 1-percent increase in resale housing prices, or a 0.4-percent increase in real mortgage interest rates. Hence the anticipated coefficient of the real estate brokerage commission rate in relation to LGIR would only be about 0.4 that of MOR in relation to LGIR, i.e., 0.4 x -1.5, equal to -0.6. Therefore a 1-percent increase in commission rates would reduce the demand for brokerage services by 0.6 percent. However, the 1-percent increase in commission rates (from 7 to 8 percent) is equivalent to a

13-percent increase in the *price* of the brokerage service. Hence brokerage services are characterized by inelastic demand with respect to price, i.e., an elasticity coefficient of 0.6/13, or about 0.05. This result is not surprising in view of the Marshallian analysis of price elasticity where the demand for a factor of production (real estate brokerage) is price-inelastic if it is "unimportant" as a percentage of the total cost of production (purchase of a resale home). Clearly brokerage, representing only 7 percent of the cost of purchasing a resale home, is a relatively "unimportant" cost component.

The price-inelastic demand for brokerage services, in the market as a whole, undoubtedly explains the *collective* resistance of real estate brokers to any erosion of current commission rates. For example, a halving of commission rates from 7 to 3.5 percent would increase the demand for brokerage services by only 2 percent; would almost halve aggregate commission revenues; and would dramatically reduce profits. *Individual* brokers might have some incentives to discount commission rates below the 7-percent level,[15] but pressure on advertisers by other members of the real estate board (REB) to boycott the advertisements of discounters may limit the scope for discounting. In addition, REBs may refuse MLS access to discount brokers, or its members may boycott (refuse to sell) the MLS listings of discounters. Most important, homeowners may judge quality by price and refrain from dealing with "discount brokers." In this regard homeowners may be partially justified. They are probably correct in their willingness to continue paying the traditional preset half of the formula commission (e.g., 3 or 3.5 percent) to the selling broker in order to maintain broker incentives to locate buyers. However, recent discussions within some local boards reveal that there are pressures by smaller brokers—who capture disproportionately large sales shares—to reduce listing commissions, suggesting that the listing commission may be over-compensatory. Hence homeowners might wish to disregard mass-media advertising by large national brokers and seek out a small broker with lower listing fees, or attempt to negotiate discounts in the formula listing commission rates typically quoted by large brokers. Those listing through the MLS could probably pay a modest fixed fee, or perhaps a 1- or 2-percent commission rate to the listing broker, while still offering a 3- or 3.5-percent commission rate to the selling broker. They would accordingly remit overall commission rates of only 4 or 5 percent.

Although this regression analysis is by no means definitive, if for no other reason than the overly aggregated nature of the dependent variable, it is at least suggestive. There has been a recent and rapid growth in real estate brokerage due to rising turnover of the owned housing stock. There is a significant negative relation between real mortgage interest rates and brokerage activity. Finally, there is a highly inelastic demand for real estate brokerage services with respect to commission rates for the market as a whole.

NOTES

1. Residential rental transactions, as well as commercial transactions, appear to be most often handled by in-house sales staff employed by real estate operators.
2. Renters change residence more frequently, about 25 percent per annum. They too are moving more frequently than in the past, albeit by only a few percent.
3. Generally, real housing prices and percentage commission rates, especially the latter, have shown little secular trend.
4. This service, like many others, did not survive the market test. Perhaps it was unable to reach a critical mass before experiencing a cash-flow crisis, or perhaps the MLS, with its related broker participation, offers far more than a pure and simple information service (e.g., a market-making function).
5. Both companies offered real estate brokerage and mortgage services.
6. From 5,326 in 1971 to 21,085 in 1981.
7. Real housing prices are typically much less volatile than the interest rates, as is demonstrated below.
8. For example, a low of $410, a median of $640, and a high of $900 on a $70,000 mortgage with 5 percent annual inflation.
9. Measured in millions of 1971 dollars.
10. MOR was a decimal, calculated as the difference between the annual nominal interest rate for five-year mortgage renewals and the most recent change in the CPI.
11. Excess growth, 1972-85, was 5.38 - 3.71 = 1.67 percent annually.
12. Excess growth, 1972-85, was 7.0 - 5.7 = 1.3 percent annually.
13. From 3 percent, early 1970s, to 4 percent, early 1980s, to 5 percent, mid-1980s, or an annual growth *rate* of about 3 percent.
14. Not expected to be in effect upon subsequent renewals.
15. Some have done so with temporary success. See "Cut-rate Realtor's Fight," 1987, p. F7.

CHAPTER 6

WELFARE AND INCOME DISTRIBUTION EFFECTS

EMPLOYMENT

Employment in real estate brokerage has grown at above-average rates during the past few decades. Employment of real estate salespersons in general (5172s) grew at annual rates of 8.5 percent, 1961-81; 7 percent, 1961-71; and 10 percent, 1971-81 (according to the census). Employment of full-time male equivalent (FTME) 5172s grew at annual rates estimated to be about 9 percent, 1971-81. These rates were well above those for the entire workforce—about 3 percent in all three periods.

Employment of 5172s in the real estate brokerage industry grew at an estimated annual rate of 8 percent, 1971-81. This growth experience is consistent with the estimated annual growth of Canadian Real Estate Association (CREA) membership over the same period. Employment of all occupations in real estate brokerage grew at an estimated annual rate of 7.5 percent, 1971-81, compared to 5.1 percent for Standard Industrial Classification (SIC) 735 and 10.2 percent for SIC 737.[1]

In terms of the employment share of real estate agencies (REAs), they constituted an estimated 0.41 percent of all industries' employment in 1971 and 0.62 percent in 1981. This compares with employment shares for all real estate salespersons (5172s) of 0.26 and 0.48 percent respectively, and shares for real estate salespersons employed by brokerage firms of 0.19 percent and 0.31 percent respectively. Employment shares tended to be about one-half of these levels in the Atlantic, Quebec, and northern territories in 1981, but growth rates were about one-half more, indicating that a transitional "catch-up" is occurring in those regions. Ultimate convergence to national average levels should occur by the late 1990s, unless permanent differences emerge in regional turnover rates and brokerage access. One such permanent source of lower turnover might relate to the reduced interprovincial mobility for francophone Québécois.

A similar pattern of regional disparities exists with respect to employment shares of SIC 735 and 737, with the Atlantic provinces and the northern territories having about one-half the national average employment shares.[2] Quebec had below-average employment shares in SIC 737, but roughly average employment shares in SIC 735—largely because it has a well-developed insurance brokerage industry.

VALUE ADDED

As was discussed early in chapter 3, Statistics Canada sources blend the value added or Gross Domestic Product (GDP) of real estate brokerage with those of insurance brokerage and real estate operators into SIC 9:03. Apportioning GDP using corporate financial data and census employment data, it was estimated that about 0.30 percent of all industrial output originated in real estate brokerage in 1981.[3] This share is only about one-half the estimated employment share of real estate brokerage, probably because REAs are more labour intensive than most other industries.

The regional distribution of real estate brokerage GDP is assumed to roughly correspond to that of employment, since it is believed that technology is fairly uniform and markets are localized. Hence the Atlantic region, Quebec, and the northern territories have about one-half the national output shares in real estate brokerage, but should catch up by the late 1990s.

EARNINGS DISTRIBUTION

According to the 1981 census, average annual earnings for full-time, full-year, male real estate salespersons (5172s) were $25,000, which exceeded the average for all occupations by 17 percent. Full-time, full-year female 5172s earned $18,800, or 38 percent more than the average female. The male-female earnings differential in real estate brokerage is about one-third—compared to one-half for all occupations. Since real estate salespersons are effectively self-employed, the earnings differential is unlikely to be the result of employer discrimination. It may, however, be the result of customer discrimination; i.e., customers are less likely to list with or buy a home from a female agent.

An alternative explanation for the male-female earnings differential would be any lower weekly hours for females. Married females in particular appear to contribute about 10 to 20 hours more per week than their husbands to household duties. Arguably, they would be somewhat less involved in real estate brokerage activities (Bruce 1985, pp. 264-66). This explanation is plausible in light of the higher proportion of part-time employment among female 5172s—53 percent compared to 33 percent for males.

Higher educational attainment would appear to have little relevance to the excess of full-time 5172 earnings over those of all occupations, or the excess of male over female 5172 earnings. Both male and female 5172s have an average of about 13 years of formal education, including prelicensing courses. This only slightly exceeds the 12 years for all occupations. Moreover, 5172 earnings exceeded earnings for all occupations, and 5172 earnings for males exceeded those of females, for the same education and age classes (1981 census). The only exception was male university graduates. Male 5172s with university degrees earned 6 percent less than all male university graduates, possibly because they rarely have graduate degrees.

Similar patterns appear to emerge on a regional basis. With few exceptions, average full-time earnings for real estate salespersons exceeded the provincial average for all occupations. This was true both in general and for various sex, education, and age categories. A notable exception was Ontario, where male 5172 earnings were 3 percent less than those of all occupations. Also, male 5172 earnings exceeded female earnings in general and for various education and age categories. One exception was Manitoba, where female 5172 earnings exceeded male earnings by 7 percent.

The coefficient of variation of 5172 earnings across provinces was about 23 percent, which exceeded the 9 percent value for all occupations. Since 5172 earnings were positively correlated with all earnings across provinces,[4] and generally 5172 earnings exceeded all earnings, real estate brokerage exacerbates overall regional income disparities.

According to Statistics Canada *Employment, Earnings and Hours*, average 1986 earnings in SIC 735, $22,730, were roughly equal to the average for all industries. However, salaried employees in SIC 735 earned 21 percent less than in other industries. In addition, hourly employees earned 35 percent less. This is probably because such employees in SIC 735 were typically clerical rather than managerial. In contrast, other (commission) employees earned 52 percent more, undoubtedly because most were commission salespersons or managers. Annual earnings for the three groups in SIC 735 were $21,375, $11,735, and $29,455 respectively.

The earnings shortfall of hourly employees in SIC 735 is partly attributable to their shorter hours—17 percent fewer than for other industries. The higher earnings of commission employees in SIC 735 may be partly due to longer hours.

Among real estate salespersons (5172s) there is a considerable range of earnings, even among full-time, full-year employees. The 1981 census can be interpreted as indicating a range of earnings for full-time real estate salespersons as follows: $12,700 to $102,200 (males) and $12,600 to $64,000 (females). Respective medians and averages were $24,680 and

$25,000 for males, and $18,790 and $18,806 for females.[5] These ranges are wider than similarly estimated ranges for all occupations: $13,500 to $95,400 (males) and $9,900 to $39,800 (females). Hence real estate brokerage may widen overall income inequality.

Another source, CREA (1976b, p. 21), reports "an uneven distribution in income of salespersons." Quartile earnings shares were as follows: 3, 14, 26, and 57 percent. Discarding the one-third of salespersons who were part-time,[6] the earnings disparity between full-time workers is such that the top 25 percent of salespersons experienced average earnings almost four times those of the lowest 25 percent. More spectacularly, the top 5 percent of salespersons[7] achieved average earnings which were about ten times as high as the bottom 5 percent.

The effects of age, sex, years licensed, and firm size as determinants of earnings inequality are also examined in the CREA (1976b) report. For example, middle-aged males with two or more years of licensed experience had the highest average earnings. In addition firm size had little effect on earnings.

Recent press releases also indicate considerable interfirm disparity in salesperson earnings, particularly favouring the large national and franchised firms. Although most salespersons average four to five transactions per year, Re/Max salespersons allegedly averaged about 18 transactions and $80,000 per year—(Brodle 1985, p. 21). Another source alleges Re/Max salespersons average 37 house sales per year, compared to 24 or 25 in other major companies (Ferguson 1986, p. 43). An analysis of Royal LePage[8] reports that its salespersons average 15 sales per year, compared to only nine in a major U.S. company. While these figures seem spectacularly above the industry average, they are corroborative of census and CREA indications of considerable interpersonal, if not interfirm, variation in earnings per salesperson. The apparent concentration of the more talented salespersons in the major brokerages is encouraged by the successful advertising and branding strategies pursued by those brokerages. This concentration may explain some of the supernormal industry average profit rates detailed in the next section.

PROFITABILITY

According to Statistics Canada *Corporation Financial Statistics*, the profit-to-equity ratio for SIC 735 averaged 23.1 percent, with a standard deviation (SD) of 1.9 percent and a coefficient of variation (CV) of 8.4 percent (1974-84). Table 11 compares these values with those for all services, and all industries.

Obviously SIC 735, and arguably real estate brokerage in particular, has enjoyed above-average profitability, with below-average intertemporal

variability. Possible explanations of its excess profitability are the pre-1976 formal commission-fixing arrangements through local real estate boards (REBs), and post-1976 concentration and branding. Another is a general scarcity of talented salespersons, who concentrate in the larger firms. Large brokerages thereby achieve above-normal profits, with smaller firms earning only normal profits. In the future, the growth of 95 to 100 percent full-commission firms such as Re/Max may ultimately permit the fuller appropriation of the excess profits by scarce, talented salespersons. Accordingly, industry profit levels may ultimately fall to more normal values.

Table 11

Average Annual Profitability, Selected Industry Groupings, 1974–84

Industry	Profit-Equity (1) (percent)	Standard Deviation (2) (percent)	Coefficient of Variation (3)=(2)/(1) (percent)
SIC 735, Insurance and Real Estate Agencies	23.1	1.9	8.4
All Services	16.4	2.6	15.9
All Industries	12.2	2.6	21.4

Source: Statistics Canada, *Corporation Financial Statistics*.

Anecdotal evidence supports the contention of excess profitability in REAs, especially larger firms. It was recently reported that, during 1986, Royal LePage achieved a profit-to-equity ratio of a phenomenal 45 percent.[9] In addition, the recent sale of five-year franchise rights by the Re/Max organization for $15,000, plus $70 monthly for each salesperson employed, is suggestive of exploitable excess profitability (Ferguson 1986, p. 43). The defection of numerous top salespersons at Royal LePage to Re/Max and other full-commission companies, as well as the growth of additional franchises such as NRS, may do much to erode corporations' and franchises' excess profitability and enrich scarce, talented salespersons. In turn, the entry of new talented salespersons in response to rising earnings could do much to diminish any excess earnings for salespersons. Such entry might reduce average individual sales, as well as commission rates, among top salespersons.

INDUSTRY VARIABILITY

In terms of simple annual growth rates of real GDP, 1971-85, SIC 9:03 was less variable than all industries (table 12).

Table 12
Average Annual Output Growth Rates, 1971 to 1985

Industry	Growth Rate (1) (percent)	Standard Deviation (2) (percent)	Coefficient of Variation (3) = (2)/(1) (percent)
SIC 903, Insurance Agencies and Real Estate Business	5.2	3.1	60
All Industries	3.3	2.8	85
MLS Unit Sales	10.5	12.0	114
MLS Real Commissions	11.7	15.6	133

Sources: Statistics Canada, *Gross Domestic Product by Industry*; and CREA, *Annual Statistical Survey, MLS*, 1985.

Such relative stability is made more plausible in view of the intertemporal stability of the profit-to-equity ratio for SIC 735. However, much more variability over time for the real estate brokerage industry in particular is suggested by an examination of MLS sales data. Over the period 1971-85, MLS unit sales grew at about treble the rate of all industries, with half-again the variability over time. The real value of Multiple Listing Services (MLS) commissions[10] grew even more rapidly and with greater variability. It would appear that the number of resales, rather than real housing prices, is the primary source of real estate brokerage variability as reflected in the real annual growth rates of MLS commissions.[11]

In terms of industry survival rates, Statistics Canada sources[12] indicate that, between 1978 and 1984, about one-third of firms in SIC 735 deceased. However, a net growth of 40 percent in the number of firms resulted from even greater new entry—53 percent between 1978 and 1984. Such rates of firm exit and entry are consistent with similar observations of substantial labour turnover. The proportions of payroll involved in deaths (22.5 percent) and births (28.1 percent) were much smaller. Smaller firms, with less

than five employees, were more likely to be involved in such status changes. However, subsequent mergers between A.E. LePage and Royal Trust, and Canada Trust and Canada Permanent Trust, would substantially qualify this last observation.

NOTES

1. Employment of 5172s in SIC 737, real estate operators, grew at an even higher rate, 14 percent.
2. National shares were 0.96 and 0.70 percent for the two industries.
3. Or 0.44 percent of all GDP.
4. Correlation coefficients were 0.86 for males, 0.60 for females.
5. For males (or females), the average income for those earning above $30,000 (or $15,000) was calculated using data on the number of such earners, the total number of workers, the average earnings for all workers, the number of workers in each earnings bracket, and the mid-points of each bracket. All full-time workers were assumed to earn more than part-time workers. The distribution of workers in the above $30,000 (or $15,000) bracket was assumed to decay linearly from the lower bound of the bracket, through the average for the bracket (with three-quarters the frequency of the lower bound), and thence to the estimated upper bound of the bracket.
6. An average derived from the 1971 and 1981 census.
7. They earned 19 percent of all earnings.
8. Financial Times News Service 1987, p. 61.
9. Ibid. It was about twice as profitable as its U.S. counterpart, Fine Homes.
10. Calculated as 7 percent of CPI-adjusted average property value, times unit sales.
11. The correlation between annual growth rates of commissions was greater with unit sales (r=0.89) than with house prices (r=0.67).
12. Statistics Canada, *Business Micro-data Integration and Analysis.*

CHAPTER 7

MAJOR ISSUES AND GOVERNMENT POLICY

As was recognized by Rosenbluth (1976, chapter 10), the most important issue involving real estate brokerage in 1976, and arguably still today, is the perceived lack of efficiency associated with restricted price/commission competition and access to the Multiple Listing Service (MLS). Other issues involve the desirability of the recent trend toward deregulation, possibly with more autonomous self-regulation, and the very recent trend toward the packaging of real estate brokerage with mortgage services.

COMPETITION AND EFFICIENCY

Competition with respect to commission rates was negligible prior to the 1976 amendments to the Combines Investigation Act (now called the Competition Act). Until 1976, all large and most small real estate brokers belonged to their local real estate board (REB), in part to gain access to the MLS. Members of REBs were required to adhere to fixed commission formulae: in eastern Canada, 5 percent on exclusive and 6 percent on MLS transactions; and, in western Canada, 6 and 7 percent respectively, but with a marginal rate of 2.5 or 3 percent for house values exceeding $100,000. No official discounting of commission rates was evident and non-cash *inducements* were forbidden.

In addition to commission rates being fixed, entry conditions were easy. Hence the consequence of changing industry conditions (such as increased property turnover rates, higher real property values, or greater labour productivity via computers) tended to be a roughly proportionate increase in the number of salespersons. Labour productivity, as measured by annual unit sales per salesperson, was virtually stationary in spite of growing access to the MLS technology. Non-price competition, in the form of intensive solicitations for listings and name-brand advertising for the broker or individual salesperson, seems to have increased substantially. Such out-

comes are inefficient compared to those of a competitive market, where unit sales per salesperson would have risen significantly and non-price competition would have been minimal.

Since 1976, the fixing of commission rates has been illegal and rates have theoretically been free to fluctuate. However, observed rates seem to have varied only infrequently from traditional formula levels. Most variation seems typically to have involved a handful of small brokers and the less visible Exclusive Listings Service (ELS), rather than MLS, transactions. Moreover, REBs continued to forbid non-cash inducements.

MLS transactions are theoretically less amenable to discounting because they are highly visible. Information, including listing agent's identity, total commission rate, and split between selling and listing agent, is typically published in the MLS listing catalogues accessed by all REB members. Even the selling agent is identified in published MLS sales summaries. Islam and Jenkins (1985, p. 65) found that discounting of both types of commission rates reached an estimated high of one sale in six in Edmonton during 1979. Fewer than 10 percent of MLS and in excess of 20 percent of ELS commissions were discounted. Among all transactions, fewer than one in ten commissions were discounted by the top ten agents, compared to more than one in four by other agents. However, the discounting of MLS commission rates had fallen by over one-half by 1983, to less than 5 percent of all transactions. This infrequency of discounting contrasts remarkably with the widespread discounting and restructuring of commissions which arose upon deregulation of the commission structure of the New York Stock Exchange (Porter 1983), and was expected to occur upon deregulation of the Toronto Stock Exchange (Todd 1983).

The lack of commission-rate discounting has been further exacerbated by the suspected actions of at least one local real estate board to inhibit discounting. A recent case involving Jim Middelkamp, the Fraser Valley Real Estate Board, and Hacker Press is illustrative.[1] It is alleged that the FVREB placed informal pressure on Hacker Press to exclude commission advertising from its weekly *Real Estate Review*. This measure, beginning May 1986, dramatically reduced the sales and commissions of Middelkamp's company. Middelkamp accordingly lost his top sales standing in the MLS achieved through advertised commission rates 1.5 percent below the customary 7 percent. Subsequently, federal investigators raided several other local real estate boards with a view to uncovering similar restrictive practices.

Commission-rate discounting may have been further inhibited by the recently alleged actions of a number of local REBs. The regulation deal negotiated by the Bureau of Competition Policy with the Canadian Real Estate Association (CREA) apparently seeks to end the practice of some boards' denying access by discount brokers to computerized listing ser-

vices.[2] Other attempts by local REBs or members to inhibit competition are partially documented. Members of a local REB in southwestern Ontario agreed to a minimum split on commission rates and were subsequently investigated and warned not to set minimum overall levels for commission rates.[3] Notaries in Quebec were the subject of a complaint, perhaps by realtors, as a result of their introduction of a computerized property information bank. This listing service involved allegedly predatory commission rates in the 2 to 5-percent range, well below realtors' rates of 6 to 7 percent.[4] Bartlett (1981, p. 83) reports prosecutions of U.S. realtors for price fixing. Other studies involving real estate brokerage, by the federal Department of Consumer and Corporate Affairs, are under way ("A Study of Inflation in Real Estate Transactions"). These may be partly motivated by recent disputes within local real estate boards. Such disputes arose when large members, who dominated MLS listings through brand name effects, lost many sales to smaller members. Large members then threatened to form a new MLS excluding smaller members, e.g., Montreal, 1981, and Toronto, 1986. Such fragmentation of the MLS could ultimately further industry domination by large brokers, in addition to being inefficient.

It seems that discounting, or variation in general, of commission rates has been stimulated very little by the 1976 Combines Investigation Act. Nor has there been much, or any, introduction of alternative types of commission formulae. For example, a formula could involve a flat fee for listing, a flat fee for locating a buyer at a minimum, independently appraised, value, plus a large percentage, e.g., 25 percent, for any sale value in excess of the minimum appraised value. Such formulae have yet to emerge—even though they might do more to encourage intense search.

Several factors contribute to the explanation of downwardly inflexible commission formulae since effective deregulation in 1976. Increasing industry concentration, especially through mergers, as documented in chapter 2 and by Islam and Jenkins (1985, p. 66), has direct implications for market power (Saving 1970; Hause 1977).

Open pricing and its implicit disclosure of market share data is another. In particular, the publication of total commission and split in MLS listing catalogues reveals listing as well as selling agent's commissions to other agents. Only the selling agent's commission rate is directly relevant to other agents and should therefore be published. The publication of the identity of the selling agent, in MLS sales summaries, provides detailed information on the implicit market shares of individual brokers. Such publication enables the ready solution of the problem of detecting "cheating" or discounting behaviour and so facilitates the deterrence of cheating. In so doing it reduces the inherent instability of collusive/cartel arrangements (Osborne 1976; Spence 1978), and sustains prices and profits.

A third factor inhibiting discounting is the relative growth of the MLS. The MLS transaction is highly visible and is therefore theoretically less suited to undetected cheating. Hence it is not surprising that it is less subject, in practice, to discounting (Islam and Jenkins 1985, p. 65). As outlined in chapter 3, MLS transactions have grown from about 72 percent of all sales in the 1970s to 88 percent in the 1980s, probably at the expense of ELS transactions.

The consequences of the lack of commission-rate flexibility (in relation to previously fixed levels) for resource allocation are minimal in one respect. Even if commissions are well above competitive levels, the small price/commission-rate elasticity of demand, say 0.05, for real estate brokerage services suggests little reduction in property turnover rates and related socially optimal resource allocation. However, an absence of commission-rate competition tends to lead to potentially wasteful non-price competition. This may especially take the form of intensive, somewhat rivalrously offsetting, solicitation of listings and brand name advertising. In addition, relatively high commission rates, together with relatively easy entry, can lead to high rates of entry and labour turnover and underemployed labour. It is difficult to imagine that labour is efficiently allocated in cases where an average salesperson makes only four or five sales annually. If average salespersons were to make ten sales per annum (somewhat less than current Royal LePage and Re/Max levels), at commission rates up to one-half less, resources consumed in real estate brokerage would be halved. Little reduction in the gross price, and a significant increase in the net price, received by home sellers might be expected. In addition, the speed and quality of buyer-property matches might increase (Carroll and Gaston 1979).

In terms of government policy, perusal of future mergers in real estate brokerage by the Bureau of Competition Policy should be very critical in order to prevent any anti-competitive increases in industry concentration. More immediately, the recent regulation deal and Prohibition Order negotiated by the Bureau with CREA concerning alleged conspiracy among brokers appears to be a step in the right direction. It seeks to end restrictions on inducements, MLS access, and advertising of commission rates and discounts.[5] Similar prohibition orders, as an alternative to prosecutions for conspiracy, have also been achieved by consent with two county legal associations involved in fixing their commissions for residential real estate services,[6] and could do much to deter future occurrences of potential price fixing. Even without prohibition orders, local REBs would be very careful to avoid future investigations of even the appearance of price fixing and related restraining practices.

As part of any prohibition order or consent decree, local REBs should be specifically required to refrain from publishing the implicit MLS commis-

sion rate accruing to the listing agent. They would be permitted to publish the selling agent's commission rate to be paid upon closing the deal (say, 3 percent), but not the total commission rate (say, 6 percent) and split (50-50 to listing/selling agent).[7] This measure would encourage more secret discounting of listing commission rates and reduce the information flow necessary to the detection of listing-broker cheaters and to ultimate cartel stability. In addition, MLS sales summaries should not identify the selling agent, or actual commission rates negotiated, for similar reasons.

Government should continue with its policy of mediating disputes involving the MLS. Such disputes could otherwise lead to large brokers leaving the MLS and forming co-operative listing services which would exclude small brokers and discounters. Government might even explicitly prohibit such fragmentation on the grounds of reduced competition and efficiency, even though the existence of two or more rival listing services would seem pro-competitive. This is because the small brokers' listing services might not survive. To the extent that the MLS is a natural monopoly, and the large national firms have created a degree of brand illusion, only the large firms' "no discounters" listing service would survive a short-term market efficiency test. Large-firm market dominance might become even greater, with competition further impaired thereafter.

Another way in which government could promote greater competition and efficiency in real estate brokerage would be through consumer information services. Potential clients would be alerted to the desirability of shopping about for a listing agent and negotiating both listing and selling commission rates. Listing clients would also be informed that they would still access a large number of potential buyers within the MLS, regardless of whether they listed with small brokers with low listing commissions, or large brokers with high listing commissions. The often disproportionately large sales share of small brokers, who appear to be eager to sell all properties regardless of the identities of listing agents, corroborates this prediction. Selling clients would also be informed of the advantages of using an MLS rather than an ELS listing so as to maximize exposure and selling price. Buying clients would be informed of their option to negotiate a lower purchase price through demanding listing-selling broker agreements on further last minute reductions in commission rates. Given the infrequency of participation by most consumers in the real estate brokerage market, such information is vital to efficient consumer decision-making and greater competition.

ACCESS TO THE MLS

One aspect of the MLS, its potentially restrictive fragmentation as a result of broker disputes, has already been discussed above. A broader issue is the

liberalized access to the MLS, not only by brokers, regardless of their discounting behaviour, but also directly by home sellers and buyers. It is an issue of considerable importance to the competitiveness and efficiency of real estate brokerage in particular, and resale housing markets in general. This matter has been examined at some length by Rosenbluth (1976, chapter 10). He argued that the MLS is a natural monopoly, which in turn implies that all brokers, and any homeowners wishing to sell by owner, should have cost-based direct access to the MLS.[8]

That the MLS is a natural monopoly seems plausible in view of the following considerations. First, network economies of scale in information processing and dissemination conceivably are large and not exhausted in most urban centres. The increasing use of the MLS between the 1970s and the 1980s supports this contention. Second, there tends to be only one MLS system per urban centre. One notable exception is Fort McMurray, Alberta, where a dispute between Royal LePage and Re/Max appears to have led to the creation of a second MLS. However, this arrangement is arguably inefficient and may only be sustained by MLS commission rates potentially in excess of competitive levels and by the backing of the second MLS by Re/Max.[9] Third, computerized listing services sold directly to homeowners, such as Komputermatch in Edmonton, have not as yet been significant, or even viable.

It might seem that local REBs are well within their rights to limit direct MLS access to member agents, without regard to their discounting behaviour. However, some homeowners, industry analysts such as Rosenbluth (1976, chapter 10), and possibly some legislators feel that local REBs should not be permitted to refuse cost-based, direct MLS access to homeowners wishing to both list and sell by owner, or to list only,[10] and to buyers wishing to purchase a sale-by-owner home.

A hypothetical historical counterexample might provide some insights into the merits of current restrictions on MLS access. Imagine that several decades ago, the real estate market in Metropolis was a mixture of exclusive-listing brokerage transactions and sales by owners. Sensing a mutually beneficial opportunity, a new commercial entity, the Co-op Listing Services Ltd., or CLS, came into existence. CLS began offering listing services to both brokers and homeowners for a modest, albeit somewhat monopolistic, one-time or monthly fee. Prospective buyers could purchase the monthly catalogue, or even receive it free. Use of the CLS became widespread. Quite recently, a group of realtors, acting collectively or through their local REB, bought controlling interest in CLS. Shortly thereafter, the CLS discontinued provision of direct listing services to homeowners and catalogues to buyers. Since that time, CLS has allowed listing and direct access privileges to brokers only—for the "public good."

Some observers might view such an outcome as a deliberate attempt to monopolize or restrain trade,[11] especially if entry into the "listing industry" were infeasible due to natural monopoly. They might draw parallels with the hypothetical purchase by brokers of the local newspaper and subsequent refusal to accept advertisements from homeowners wishing to sell by owner. As a result, they might also view as a restraint of trade the refusal of today's REBs to permit direct homeowner access to the MLS.

Rosenbluth (1976, chapter 10) examines two public policy responses to the current restrictiveness of the MLS. The first is the establishment of a competing, state-operated listing service in conjunction with land titles offices. The second is a simpler, but more radical, approach involving liberalized access to the current MLS, possibly with a condition that all listed properties be professionally appraised. Unless local REBs demonstrated probable public harm from direct homeowner access to the MLS, provincial governments[12] would legislate direct consumer access to the MLS, i.e., an open MLS. This liberalization might be introduced on an initial experimental basis in one municipality, and results evaluated after a period of, say, a year. If satisfactory, it would be expanded. Many consumers would still use agents, particularly in the selling process, albeit at potentially lower commission rates. They would do so because they perceived a higher possible selling price, using agents' salesmanship, and greater convenience. Other consumers would exercise the choice of direct listing and selling. Greater market efficiency is a potential outcome of a common information process for broker and by-owner sales. Brokerage pricing and service levels might become more fully competitive, particularly in generating a broader spectrum of commission arrangements.

REGULATION

There is a long-standing tradition of agent licensure and other regulation, such as bonding and complaint processing, in real estate brokerage. However, the current impetus would appear to be toward a degree of deregulation. For example, some provinces still require the testing, but not licensing, of salespersons. Some have delegated industry self-regulation to provincial real estate associations, or REBs, to "license" and discipline member brokers and salespersons.

Deregulation, accompanied by ongoing scrutiny of the industry by the Director of Investigation and Research, the Competition Act, along with certain minimum safeguards, could enhance overall efficiency. For example, it might eliminate any unnecessary educational requirements, delays in licensing, or impediments to innovative commission structures,[13] without undesirable reductions in the quality of brokerage service. However, to the extent that deregulation is extensive, for example eliminat-

ing most existing state controls and establishing any minimal industry self-regulatory mechanisms, a combination of competition and an efficient civil litigative mechanism[14] are vital to its success.

If deregulation either preserves existing exclusive practice or licensure, or introduces the more competitive alternative of certification,[15] it should include provisions for the legislated establishment of single, or multiple, industry self-regulating organizations (SROs). SROs would be required to comply with certain minimum legislated standards. These would include provisions for public representation on governing and disciplinary bodies; veto by the Lieutenant Governor in Council of undue escalation of educational standards and other actions aimed at unreasonably restricting entry into the industry; prohibitions on price-fixing and artificial technological rules;[16] restrictions on commission-rate and other reasonable advertising; and provisions requiring the open and reasonable direct access of homeowners to the MLS. Such safeguards are advisable in view of Carroll and Gaston (1979), who find restrictive licensure in real estate brokerage led to lower quality of service.[17] For further discussion of licensure, certification, and self-regulation, see Jenkins (1986).

Rosenbluth (1976, p. 80) is especially enthusiastic about the evolution of a spectrum of innovative commission rates in a deregulated, more competitive context. Such innovations could lower total commission costs, increase sale prices, or improve matches, since they would provide greater sales incentives. An example would be a commission consisting of 2 percent of an independently appraised minimum selling price,[18] plus 50 percent of any excess of actual sale price over this minimum. Zorne and Larsen (1986) also examine alternative commission structures—flat and percentage. Perhaps deregulation and greater competition, especially accompanied by direct homeowner access to the MLS, would evolve an efficient combination of the two.

Government should resist unreasonable pressure from brokers to introduce limits on enrolments in pre-licensing courses.[19] In so doing, it will preserve the easy entry conditions so vital to future competition. Government should have little fear of educational resources being "wasted" through high entry and exit rates. Since pre-licensing courses are typically completed by part-time correspondence study of a few months' duration, with little materials cost and classroom instruction, few resources would be consumed "unnecessarily." Moreover, trial-and-error entry and exit may be the most desirable mechanism for labour force recruitment in real estate brokerage. Even the "failures," or exits, are ultimately better-informed homeowners, sellers, and buyers!

Government should also resist lobbying by real estate brokerage SROs to escalate legislated minimum educational standards. It would appear that in one province, B.C., this has not been the case—new, as opposed to

"grandfathered," real estate brokers must now complete a two-year postsecondary programme in real estate studies prior to licensing. If higher educational standards for agents were desired by some consumers of real estate brokerage services, surely the consumer would *voluntarily* choose to deal with, and pay for, brokers having the appropriate designation (Bachelor of Real Estate Science or Arts?). Mandatory higher education could, ironically, squander educational resources.

A further area in which government should be vigilant is in the area of industry pressure to restrict licenses or SRO membership to full-time salespersons only. Given the considerable involvement of part-day/week/month/year salespersons in real estate brokerage,[20] such restrictions would seem an infringement of individual rights, especially those of females. Such restrictions would provide little or no demonstrable gain in salesperson efficiency, and might even create inefficiency in the solution of peak-load or seasonal demand problems. Moreover, desired flexibility in the response of the industry to cyclical swings in resale housing would be reduced. Worse yet, chronic labour shortages might emerge in real estate brokerage.

One further area in which government should resist industry coercion concerns demands to vigorously enforce, or even strengthen, requirements that a full-time designated manager be employed in each individual office of a brokerage company.[21] Such coercion, if successful, could especially undermine the viability of full commission companies. It would thereby reduce competition for talented salespersons, diminish cost-reducing, efficiency-increasing innovation, and forestall lower commissions. Since traditional companies have yet to demonstrate that companies like Re/Max are involved more frequently in consumer complaints, their demands for more supervision should be examined very skeptically.

PACKAGING OF REAL ESTATE BROKERAGE AND MORTGAGE SERVICES

Although believed by some industry observers to be little more than a sales tool, the introduction of pre-approved mortgages, both for properties and buyers, is believed by others to create additional market share and market power for the large brokers offering both real estate and mortgage brokerage products.[22] Beginning in 1985, Royal LePage, as well as other companies, began offering a service whereby its listed properties were assigned a maximum mortgageable value, and buyers dealing with its realtors could receive advance eligibility for maximum mortgage creditworthiness. In 1986, Re/Max, which had no ownership links with a trust company or other financial institution, arranged pre-approved mortgage credit limits for its buyer clients with the Toronto Dominion Bank.

The pre-approval of properties for mortgageability is often little more than a formality. The pre-approval of a buyer's creditworthiness probably has little effect on his ultimate ability to qualify for a mortgage. Nonetheless, the pre-approval of properties may have considerable value in attracting listings. The pre-approval of creditworthiness appeals to buyers who crave convenience, are unsure of their creditworthiness, or believe, rightly or wrongly, that they can avoid out-of-pocket transaction costs[23] through ultimate purchase of the package. Hence Royal LePage, Canada Trust, and even Re/Max undoubtedly expect to attract more listings and buyers and enjoy greater commission income and market share. They may even increase their mortgage-lending business; e.g., Royal LePage reports an extra $600 million in 1985 and $1.0 billion in 1986.[24]

To the extent that packaging reduces the number of cases in which a conditional sale is subsequently aborted because the buyer is unable to arrange suitable financing, it conserves real brokerage resources and is of potential social benefit. However, mortgage pre-approval has been available without packaging for many years, unbeknownst to many buyers. Hence, government-sponsored consumer information programmes would provide an alternative to packaging.

Potential social costs might arise from packaging if it were to enhance further the market dominance of the large brokers. This dominance has grown rapidly in recent years, both by merger and by advertising. Its contribution to aggregate market power is enhanced by the high degree of industry organization in the form of the REBs and MLS. Temporary cross-subsidization[25] could further increase industry concentration—in both brokerage and mortgage markets.

Government should respond to packaging through consumer information programmes and brochures emphasizing the availability of mortgage pre-approval for buyers through independent financial institutions. It should also highlight the importance of buyers' shopping around for the best available mortgage rate and terms. Finally, it might reconsider the wisdom of joint ownership of real estate brokerage and mortgage institutions, or consider "Chinese walls"—although such measures would run somewhat counter to recent deregulation of the financial sector. Finally, it might require that brokers provide brochures to buyers, upon initial contact, which would provide information on their rights and options in real estate brokerage, home purchase, and mortgage financing. These rights include mortgaging their home purchase through an independent financial institution, rather than that involved in the offered package.

A further element of packaging may soon emerge through the Royal LePage financial linkages with the London Life and Wellington Insurance Companies.[26] Royal LePage realty clients might be encouraged to apply for pre-approved, broker-recommended property and mortgage-related life in-

surance. Again, possible social benefits, especially reduced transaction costs, may arise from packaging. However, there are also possible social costs, particularly increased market concentration and related market power consequences. Hence a government policy response, especially a consumer information programme, is indicated.

A final experiment in packaging may be pro-competitive. As noted earlier,[27] Quebec notaries appear to have been offering both legal and brokerage services in real estate conveyance activities. Brokerage commission rates were lower than traditional ELS (and MLS) levels of 6 (and 7) percent, i.e., 2 to 5 percent. It seems plausible that it was *brokers* who complained about "unfair" competition. Hence such pro-competitive experiments should be tolerated by government, if not actively encouraged, to the extent that they present no obvious conflict of interest or other problems.

SUMMARY OF MAJOR POLICY RECOMMENDATIONS

Mergers

Perhaps the single strongest recommendation is that future mergers involving any of, say, the top ten realtors[28] should be subject to very critical scrutiny by the Bureau of Competition Policy, Director of Investigation and Research, or Competition Tribunal. The amalgamation of major national realtors may be no more efficient for brokerage transactions than co-operation or interconnection among the local MLS systems, or the formation of computerized networks for ELS listings.[29] The amalgamation of local realtors may be redundant in view of the predominance of the MLS transaction. Industry concentration has increased dramatically in level and upward trend, mostly through mergers, and even closer scrutiny may be desirable under the new and flexible Competition Act.

Franchises

Since franchising reconciles small, efficient production scale with large, efficient promotion scale, franchises provide an important alternative to the dominance of large brokers like Royal LePage and Canada Trust. Large franchises are made up of small, essentially independent firms,[30] and hence are more pro-competitive than large traditional firms like Royal LePage. Hence government should resist any pressures to restrict the entry and expansion of franchises, especially full commission franchises like Re/Max. It should, however, ensure that franchising requirements exclude uniform commissions. Provincial governments should also resist unreasonable demands to impose supervision quotas on franchised and other full-com-

mission realtors. In so doing, government will promote interfranchise and interbrokerage competition, efficiency, and innovation.

MLS

Government, especially the federal government through the Competition Act, should consider prohibiting the open pricing policy incorporated in the MLS listing catalogues. Under open pricing, the MLS listing for each property includes the value of the total commission and split between listing and selling broker, and the MLS sales summaries identify the selling broker for each property sold. If open pricing were prohibited, listing catalogues would reveal the commission payable to the selling broker only, while sales summaries would exclude the identity of the selling broker. They would still provide the desired information for purposes of selling properties such as property characteristics and selling price. However, they would no longer provide the feedback to other brokers on listing commissions and market shares of selling brokers which is critical to the detection and deterring of discounting or "cheating" within a stable cartel.

The Bureau of Competition Policy should closely monitor the regulation deal recently negotiated with CREA. In particular, it should ensure that there is no continuation of any local boards' denial of access by discount brokers to the computerized MLS.

Provincial governments should consider legislating an open MLS by prohibiting the current exclusiveness of member-broker or producer-only access to listing and buying on the MLS, possibly on a trial, geographically limited basis. They would ultimately be justified in so doing to the extent that the MLS is a natural monopoly, and current exclusive dealing practices prevent homeowners from direct, cost-based listing on the MLS. Buyers would be permitted cost-based, direct access to listing catalogues and direct contact with selling agents, listing agents, or homeowners in sale-by-owner cases. Through such liberalized access to the MLS, combined broker-owner, and especially sale-by-owner, markets might become more informationally efficient and even grow. Broker markets would generate lower commissions and more variety; for example, brokers could be involved only in selling rather than both listing and selling.

Regulation, Deregulation, and Self-Regulation

Some existing regulation is desirable, e.g., bonding and perhaps stricter enforcement of the merger and price-fixing provisions of the Competition Act. For example, local boards should not be permitted to pressure the media to exclude commission-rate advertising. Some new regulation is potentially justified, for example the enforced open access to the MLS.

Deregulation is required in some areas. Examples include the removal of any enrolment quotas in pre-licensing courses and the relaxation of unreasonable restrictions on the types of commissions permitted. Government should be reasonably unwilling to give in to industry demands for the escalation of educational standards and the introduction and enforcement of full-time-status-only and supervision quotas.[31]

Self-regulation may be desirable. However, the legislation establishing the self-regulatory organization (SRO) should clearly specify the SRO's rights and responsibilities. It should also incorporate an ultimate veto by the Lieutenant Governor in Council of any undue restrictions on commission advertising, membership, and commission rates, and the undue escalation of educational and experience standards. Legislation should also require public representation on the governing and disciplinary bodies of the SRO.

Service Packaging

Packaging of real estate brokerage, mortgage, and even insurance services by real estate brokers may be potentially efficient. Whether this is the case or not, packaging should not become coercive or misleading if it is to be directly beneficial to consumers. Perhaps more important, it should not become so predatory via cross-subsidization as to enhance further the high and rising levels of concentration in the real estate brokerage, and possibly mortgage and insurance, market. Moreover, its optional nature, and the costs of each service, brokerage, mortgage, and insurance, should be made explicit to the client—in the same way that lenders must divulge the credit costs of a loan.

Consumer Education

Given the infrequency with which homeowners transact in property markets, it is desirable that federal and provincial Departments of Consumer and Corporate Affairs publish and distribute informational brochures. Since clients may sign listing agreements before they have read brochures, a cooling down period of, say, 48 hours, during which time the client could abrogate the listing agreement, might be legislated.[32] Informational brochures would emphasize the alternative of sale-by-owner transactions, with or without use of an open MLS; the nature of broker ELS and MLS transactions, including the access to all selling agents embodied in the latter;[33] the desirability of sellers' shopping about for low commission listing brokers; the option and advantages of sellers' negotiating lower listing commissions, and selling commissions which provide more incentives; the option of "last minute" renegotiation of commissions by sellers and prospective buyers; the purely optional nature of any packaging of real

estate brokerage, mortgage, and insurance services, and the alternatives of shopping around; and the mechanisms by which unsatisfied consumers can register complaints with the SRO or government. The sale or purchase of a home is the largest single transaction made by the vast majority of consumers. Hence government should willingly make the minimal outlays on informational brochures in the interests of promoting more informationally efficient and competitive brokerage and resale housing markets.

NOTES

1. "Cut-rate Realtor's Fight," 1987, p. F7.
2. "Canadian Realtors," 1988, p. D2, and Canada, Department of Consumer and Corporate Affairs, 1988b.
3. Canada, Director of Investigation and Research, 1982, p. 46.
4. Canada, Director of Investigation and Research, 1985, p. 51.
5. "Cut-rate Realtor's Fight," 1987, p. F7.
6. Canada, Department of Consumer and Corporate Affairs, 1988a.
7. Consumers would lose little from such a prohibition, since commission-rate information is coded, homeowners seeking a listing agent do not have wide access to information in MLS catalogues, and homebuyers are only interested in gross property prices. Moreover, Osborne (1976) and Spence (1978) see such restrictions on information flow as being pro-competitive.
8. On the same terms as members of the local REB, including safeguards against misleading advertising and fraudulent practices.
9. Or other large broker.
10. But sell through an agent to whom a pre-advertised commission, say 3.5 percent, would be paid.
11. Even though such restraint wouldn't violate the "exclusive-dealing" provisions of the Competition Act, since homeowners don't compete with brokers in the usual sense.
12. Federal government jurisdiction under the Competition Act might be *ultra vires*.
13. Such as can be found, for example, in SS.39 of the Saskatchewan Real Estate Brokers Act.
14. In the event of malpractice.
15. Exclusive use of title or name.
16. Such as one manager for every ten salespersons.
17. As reflected in higher average vacancy rates for unsold homes.
18. Somewhat below the official, deliberately inflated list price.
19. Such as occurred in B.C. during the 1970s.
20. According to the 1981 census, 32 percent of males, 52 percent of females, and 40 percent of all salespersons were part-time.
21. For example, large traditional brokers such as Royal LePage have insisted that the Alberta government require the Re/Max franchise to appoint a full-time manager in each of its offices.
22. Tasko 1986.
23. Such as for appraisals.

24. Ferguson 1986, p. 46.
25. For example, buyers have recently been offered a 1/4 percent reduction in the first year of their Royal Trust mortgage if they buy a property through a Royal LePage agent.
26. Ferguson 1986. These linkages are through the Trilon conglomerate.
27. Canada, Director of Investigation and Research, 1985, p. 51.
28. In terms of national or local market shares.
29. Gilmour (1987) provides an example involving commercial properties.
30. The author found no evidence of franchises attempting to impose uniform commission rates on its members, other than a suggestive remark ascribed to the general manager of the Edmonton-area Re/Max franchise: "We tell people that if they want to pay less to go elsewhere" (Hryciuk 1988).
31. Especially since there has yet to be any demonstration of a higher frequency of consumer complaints against full-commission, minimally supervised companies like Re/Max.
32. Similar arrangements exist in many provinces for major door-to-door solicitations. Clearly a 48-hour delay in advertising the listing would also be adopted by realtors.
33. And so partially debunk the myth of inherent large-broker superiority in MLS transactions.

APPENDIX

AGENCY AND DEALER MARKETS FOR HOUSES AND CARS

The development of a used-car dealer market, as compared to the absence of a (significant) used or resale house dealer market, must reflect differences in the technology, demand, and market dynamics of the two commodity markets (cars and houses). Potentially relevant differences include the higher prices of houses compared to cars; the greater heterogeneity, but lower technological complexity, of houses compared to cars; and greater price variability and lower predictability in the housing market compared to the car market. It is a *combination* of these differences which is believed to explain the absence of a resale house dealer market, in that they lead to a high degree of risk, and a corresponding bid-ask price spread, or mark-up, in a potential house *dealer* market so large as to make an *agency* market more viable. For example, contrast a 25-percent mark-up, as is typical for used-car dealers, with the 7-percent commission paid in a resale housing transaction.

There is little doubt that housing prices exceed car prices—with the rare exception of certain exotic European imports! Resale housing prices typically are ten times higher than used-car prices, implying much higher initial inventory costs for dealers. However, the dealer can arrange dates for paying the home seller and for taking payment from the home buyer which coincide with a change of tenancy, hence minimizing vacancy. This being the case, only deposits, which may lag for the buyer by, say, two months, need to be financed. Hence it seems unlikely that high prices, in conjunction with inventory financing requirements, are a barrier to entry sufficient to escalate the bid-ask spread and preclude a resale house dealer market.

Heterogeneity of the housing stock, especially in relation to the diversity of buyer characteristics and potential incongruities, could also be greater than for used cars. It certainly increases the probability of the dealer paying too much for a house and accepting too little upon resale, but on average

these discrepancies should cancel out, with only a modest risk premium being built into the bid-ask spread.

Less technological complexity in houses than cars may reduce the need for dealers with reputations which provide some guarantee of housing quality. A visual inspection, backed up by a formal appraisal or inspection by a qualified tradesman, along with knowledge of the age of the house, are typically sufficient to inform the buyer of the quality of the house, especially the imminence of any malfunction or deterioration. Hence buyers are unlikely to be willing to pay a bid-ask spread premium for the quality guarantees, and even written warranties, implicit in dealer reputations. Buyers will generally prefer transacting through agents at commission rates lower than the bid-ask spreads associated with potential used-house dealers.

Price variability over time may be greater for houses than cars. Moreover, houses typically spend more time on the market, e.g., two to three months compared to one to two months for cars. But would not the homeowner using an agent be susceptible to the same risk as a dealer, and, if so, then why should an agent be preferred by risk-averse homeowners? The dynamics of the housing market best explain the precedence of the agency over dealer market for houses. A homeowner, contemplating sale of one house and purchase of another normally will have canvassed the market for his new home prior to listing, or at least before accepting an offer for his existing home. He is exposed to little uncertainty about the price differential between his old and new house because he, in effect, is transacting in a coincident futures market, with property transfer two or three months hence. By contrast, a used-home dealer must buy in a spot market today and, because market exposure of the home may take two or three months, sell in a spot or futures market later. He is accordingly exposed to the risk of a major downturn in housing prices due to unexpected rises in real mortgage interest rates, upswings in new house construction, or general economic downturns. Hence the resale house dealer would correspondingly demand a bid-ask spread much higher than the conventional commission rate.

The *combination* of high prices, heterogeneity, technological simplicity, and greater vulnerability to price variability are thought to interact so as to result in a bid-ask spread in a used-house dealer market which could be of the same order of magnitude as that in the used-car dealer market, e.g., 15 to 25 percent, but higher in absolute dollar magnitude, e.g., $15,000 for a home compared to $1,000 for a used car. Heterogeneity of homes and buyers additionally enhances potential price variability, time on the market, and hence risk premiums, and so further escalates the bid-ask spread. Since technological complexity of homes is minimal, there is little countervailing need for dealer reputations as a consolation for unattractively high bid-ask spreads.

Casual empiricism verifies this explanation of the absence of a significant resale house dealer market. In the few, but increasingly common, cases where used cars are sold on consignment, fees are well below the traditional used-car dealer mark-up, and the separate purchase of a formal warranty is typically involved. One local used-car dealer charges a flat fee of $162 for selling a car on consignment, regardless of time spent on the lot! Others typically charge a percentage consignment fee of roughly 5 percent. Vintage and custom cars, known for their heterogeneity, have often been, and are increasingly, sold on consignment. Contrast these agency fees—a few percent of price—with the traditional used-car dealer mark-ups—10 to 50 percent with a mean of 25 percent. One can readily appreciate why an *agency* housing market has generally pre-empted a *dealer* housing market.

Other factors may also play a role in explaining the dominance of the agency market. A dealer market might involve pre-sale of the property to the dealer in April and later resale to a buyer in June. An agency market involving the same property is more conducive to the homeowner keeping up the appearance of the property and being co-operative with viewing arrangements for prospective buyers during the April to June period of time on market. In other words, an agency market probably generates higher selling prices. Perhaps home buyers and sellers view the agent as more disinterested/objective than a dealer in advising them on the suitability of house price and other characteristics—a strange belief given the selling agent's obvious incentives to make a sale. In any event, the examination of the agency-versus-dealer question invites formal modelling and empirical investigation.

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