

NORTH CAROLINA REAL ESTATE COMMISSION



ADVISORY COMMITTEE INCENTIVE DISCLOSURE

MEETING REPORT

November 20, 2007

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INCENTIVE DISCLOSURE ADVISORY COMMITTEE

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Committee Members Present:

Kimberly D. Alston (Greensboro)
William C. Bass (Asheville)
Cindy S. Chandler (Charlotte)
Tony H. Jarrett (Greensboro)
C. Nash Lindsey, III (Fayetteville)
P. Robert Measamer, Jr. (Fayetteville)
Hampton Pitts (Raleigh)
Page Robertson (Wilmington)
James H. Sears (Gates)
Grady F. Watkins, Jr. (Holden Beach)
Assistant Attorney General Harriet Worley (Raleigh)

Commission Staff Advisors

Phillip T. Fisher, Executive Director (Facilitator)
Special Deputy Attorney General Thomas R. Miller, Legal Counsel

Others Present

Peter St. Onge, Charlotte Observer
Rick Zechini, Director of Regulatory Affairs, N.C. Association of REALTORS®

Welcome/Committee Composition

Mr. Fisher welcomed the committee members and others present for the meeting. He stated that over the years, when the Real Estate Commission has been confronted with policy issues which are especially unique or far-reaching in their impact on real estate consumers or practitioners, it has formed advisory committees to study the issues and submit to the Commission any recommendations for action. He added that in forming the committees, the Commission endeavors to assure that all perspectives and points of view relevant to the issue under consideration are represented on them. Towards this end, he stated that residential real estate brokers, commercial real estate brokers, homebuilders/developers, and real estate consumers are represented on the *Incentive Disclosure Advisory Committee*.¹

¹ Ms. Alston (Residential Broker), Ms. Chandler (Commercial Broker), Mr. Measamer (Residential Broker), Mr. Sears (Public), Mr. Pitts, (Builder/Developer), Mr. Robertson (Public), Mr. Bass (Residential Broker), Mr. Watkins (Residential Broker), Mr. Lindsey (Residential Broker), Mr. Jarrett (Residential Broker), and a representative [Ms. Worley] from the Consumer Protection Section of the North Carolina Attorney General's Office. *October 24, 2007 Commission Special Meeting minutes, p. 5.*

Background/Charge

Mr. Fisher stated that *Charlotte Observer* reporters Peter St. Onge and Binyamin Applebaum, during the course of their investigative reporting of certain activities of a Charlotte-area real estate firm, found that none of the real estate purchasers they interviewed were aware that their real estate agents had received a “bonus” from the homebuilder/seller on their purchase of the seller’s property. The question then emerged as to whether the agents directed their clients to these specific properties because they best satisfied their client’s needs or because of the additional compensation the agents would receive from their sale. When questioned by the committee, Mr. St. Onge responded that all persons interviewed had been clients of the same real estate firm.

Mr. Fisher stated that, as a result of the *Charlotte Observer* articles, the Commission formed the *Incentive Disclosure Advisory Committee* to help determine whether measures in addition to those currently in place are needed to assure that parties to real estate transactions are aware when their agents are being compensated by another party to the transaction; and if so, how and when the disclosure should be made. Mr. Fisher emphasized that the issue before the advisory committee is not whether the payment of sales incentives should be prohibited, but rather, as stated in the Commission’s charge to the advisory committee,

“[W]hether changes in Real Estate Commission rules are needed to reasonably assure that real estate purchasers and sellers are properly informed of any compensation received by or offered to their real estate agents from another party to the transaction; and if so, the rule changes necessary to accomplish this.”

Incentive Programs

The committee reviewed various advertisements from real estate publications promoting programs in which homebuilder/developers and real estate listing firms were offering “bonuses” or special “rewards” to real estate agents ranging from \$2,000 to \$10,000 for selling their properties to the agents’ clients. Mr. Fisher stated that, while the programs differ in some respects, all appear to contain the following common elements: The offer of something of value (cash, gift, etc.) usually by a real estate seller (often a homebuilder/developer or a listing firm) to a real estate agent to direct the agent’s clients (usually buyers) to the seller’s property; and that the “something of value” which is normally paid at or after the closing of the sale is in addition to the sales commission or compensation the agent would have otherwise received from the sale. The committee members agreed that the examples presented were generally representative of sales incentive programs found in the marketplace. Mr. Pitts stated that, in addition to advertising and other forms of promotion, incentive programs are a means by which builder/developers can better assure that their properties are on the list of properties real estate brokers consider showing to their clients. The real estate practitioners on the committee agreed that incentive programs are well-received in the real estate business and are more prevalent in a “shifting market” which favor purchasers.

Current Disclosure Requirements

Mr. Miller reviewed with the committee the current legal requirements imposed upon real estate agents regarding the disclosure of compensation received by them in real estate transactions. These included (1) the provision in the Real Estate License Law (N.C.G.S. 93A-6(a) (4)) prohibiting a broker from acting for more than one party in a transaction without the knowledge of all parties for whom he or she acts; (2) Real Estate Commission Rule A.0109 (b) which prohibits brokers from receiving any commission or rebate of more than nominal value for services performed for a party in a real estate transaction without “full disclosure” to such party; and (3) the federal Real Estate Settlement Procedures Act (12 USC §2603) which requires all charges imposed upon the borrower and seller in transactions involving federally- related mortgage loans to be conspicuously and clearly itemized on a uniform settlement statement (HUD-1 form) including the “Total Sales/Broker’s Commission.” Ms. Chandler pointed out that commercial real estate transactions are not subject to the Real Estate Settlement Procedures Act. Other committee members remarked that reporting incentive “gifts” on the HUD-1 form was problematic for some lenders and loan underwriters.

Discussing especially Commission Rule A.0109 (b) which addresses brokerage fees and compensation, Mr. Miller stated that, although the rule requires brokers to fully disclose to their clients their receipt of any compensation incentives, such disclosure is not required to be in writing. He also pointed out that brokers are not required to disclose incentives paid to them by the firm with which they are associated unless the firm received the incentive from a party to the transaction. In response to a question raised by Ms. Chandler, he stated that the rule was not intended to require brokers to disclose to buyers compensation received by them while acting as subagents of the seller; however, he conceded that it could be interpreted otherwise.

Ms. Chandler also pointed out and the committee members concurred that compensation incentives to real estate agents may be stated in such a way that their actual value may be difficult to determine; e.g. the party offering the incentive (usually the seller) will simply increase the sales commission percentage paid to the selling firm. Mr. Miller responded that in such case, the amount of the incentive would be the difference between the dollar amount, percentage of purchase price, etc. stated in the buyer agency agreement and the actual amount received by the selling firm. In response to concerns expressed by Mr. Zechini, Mr. Miller stated that any references to agent compensation in Commission rules would take into consideration antitrust implications.

Mr. Fisher also recognized Mr. St. Onge who inquired as to how the Commission’s current rule addresses programs in which agents receive incentives only after they sell two or more of the seller’s homes, or they sell the most homes of the seller over a period of time, or on some similar basis when the agent does not know during a particular transaction whether a sale may subsequently result in additional compensation. Mr. Miller stated that in such instances, agents are required to disclose to their clients in each transaction the potential for the agent later receiving a sales incentive from the seller; however, having then advised each client of the potential incentive, the agent would not be required to retroactively disclose his or her actual receipt of the incentive to former clients.

Current Means for Disclosure

In addition to the HUD-1 form, the committee reviewed other forms used to inform real estate consumers of compensation incentives offered to and/or received by their real estate agents. These included the North Carolina Association of REALTORS® “Exclusive Right to Represent Buyer” form used by Association members which provides that “if any additional compensation and/or a selling incentive (bonus, trip, money, etc.) is offered through the MLS or otherwise, Buyer will permit the Firm to receive it in addition to the compensation set forth above [in the agreement].” Mr. Jarrett also presented another REALTOR® form for “Confirmation of Agency Relationship, Appointment & Compensation” which *inter alia* describes and seeks the consent of the buyer and seller as appropriate to the compensation arrangement between the listing and selling firms including any other fees the selling firm is to receive in the transaction as buyer agent or seller subagent.

Mr. Fisher summarized that, in addition to any oral disclosures given by real estate brokers during the course of real estate transactions, the primary means by which real estate purchasers currently are made aware of any compensation incentives offered to and received by their agents are the mandatory HUD-1 form, the two voluntary N.C. REALTOR® forms and any other voluntary forms developed by real estate firms and homebuilders.

Elements of Proper Disclosure

Having reviewed and discussed various incentive programs utilized by real estate sellers and the current legal requirements and means for disclosing incentives offered and paid to real estate agents, the committee then proceeded to identify what, in its opinion, constitute the necessary elements of proper disclosure and whether those elements are present in the current requirements. In this regard, the committee determined that proper disclosure of incentives of more than nominal value requires:

1. That the disclosure be made in writing and preferably accompanied by an oral explanation of the incentive arrangement, that it be prominent, and that it be acknowledged by the agent’s client; but if the client fails to acknowledge the written disclosure, the broker may proceed with the transaction after noting this in his or her transaction records.
2. That the value of the incentive be disclosed and, if other than cash, a description of the incentive item and its monetary value stated.
3. That the disclosure by the agent be timely; i.e., preferably while showing properties for which an incentive is being offered, but in no event later than the making of the buyer’s offer to purchase such properties.

Sufficiency of Current Requirements and Recommendations

The committee concluded that, inasmuch as the current Commission rule requiring disclosure of the receipt of sales incentives does not mandate written disclosure and, although referring to “full disclosure”, does not address the timing or content of such disclosure, the Real Estate Commission should amend its rules to include the elements of proper disclosure which the committee identified. Further, the committee suggested that any amendments to Commission rules made in response to its recommendations be communicated and explained to real estate brokers through the Commission’s mandatory continuing education *Update* course, the *Real Estate Bulletin* newsletter and other Commission educational and informational resources.

With regard to development and distribution of a written disclosure form, Mr. Fisher stated that the Real Estate Commission typically does not develop forms for use by real estate brokers, but rather requires that such forms contain certain information prescribed by the Commission. He added that any additional disclosure requirements which may be imposed by the Commission on its licensees should not be construed to discourage or diminish the current efforts of conscientious homebuilders and other persons beyond its jurisdiction to inform consumers of their sales incentive arrangements with real estate brokers.

Adjournment

Mr. Fisher stated that he will prepare the committee report for submission to the Real Estate Commission. He stated that he would endeavor to submit the report to the Commission for its consideration at its December 12 meeting but not later than its January 15, 2008 meeting. He further stated that he will circulate a draft to committee members for their review and comments in advance of its submission to the Commission.

Mr. Fisher expressed to the committee members the appreciation of the Real Estate Commission for their careful examination and thoughtful study of this timely and important issue.

There being no further business to come before the *Incentive Disclosure Advisory Committee*, the meeting was adjourned.

Submitted by:

Phillip T. Fisher, Facilitator

This _____ day of December, 2007.