

Is Dual Agency in Housing Transactions Ethically Acceptable?: A Japan-U.S. Comparison*

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Abstract This paper focuses on the problem of real estate agents' disloyalty to their clients (buyers or sellers of houses) caused by asymmetric information, and compares several previous studies in the US to this research on the effects of dual agency deals in Japan. Dual agency means that the same real estate agent represents both seller and buyer in a housing transaction. Furthermore, this paper considers whether dual agency can be ethically accepted in housing transactions. The important point is that dual agency distorts the sale price of houses, that is, it causes information failure. Therefore, Japan should enact certain restrictions, such as the US disclosure requirements of dual agency status, into law or into the ethical codes of the real estate industry.

1. Introduction

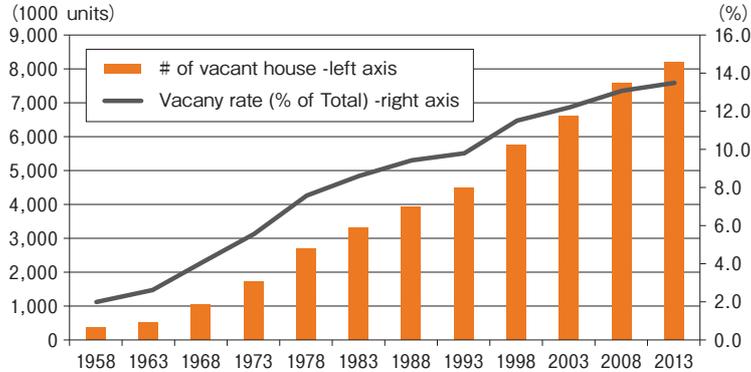
Revitalization of the existing house market is a pressing issue in Japan. Vacant houses have been increasing rapidly with the population decline in the world's fastest aging country. In 2015, 26% of the population was over 65 and this figure is expected to reach 37% by 2050¹. Approximately 8.2 million vacant houses existed in 2013, which is 14% of the total, that is, one out of seven houses was empty (Figure 1). Moreover, vacancies are still increasing. It is an urgent task for the government and society to reduce vacant houses causing external diseconomies, such as blotting the landscape and lowering neighbors' property values. If owners of vacant houses could sell them before causing trouble, the external diseconomies would be alleviated to some degree. Real estate brokers, therefore, could play a crucial role in helping

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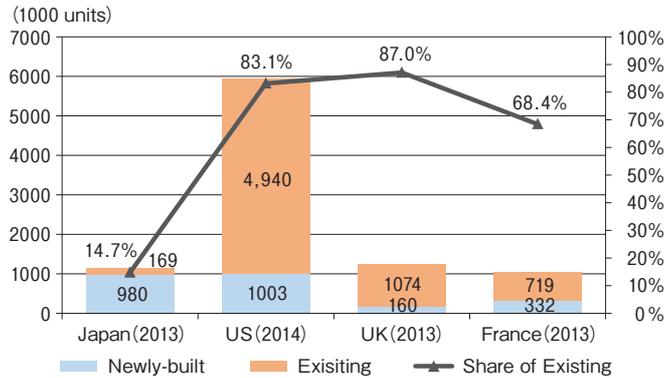
¹ United Nations World Population Prospects

Figure 1. Number of Vacant Houses and Vacancy Rate in Japan



Source: Ministry of Internal Affairs and Communications (Japan)

Figure 2. Newly-Built Houses versus Existing Houses: International Comparison



Source: Ministry of Land, Infrastructure, Transport and Tourism (Japan)

owners of vacant houses to sell them, thereby stimulating housing transactions. However, the size of the existing house market is quite small in Japan, compared to other advanced countries; the market share of existing houses was 14.7% in Japan, 83.1% in the US, 87.0% in the UK and 68.4% in France (Figure 2). Why is it extremely low only in Japan? There could be multiple reasons, for instance, the preference for quake-resistant new houses in earthquake country, the short durable lifetime of wooden dwellings compared to Western stone-built houses, the preferential taxation system for newly built houses, and the distrust of real estate brokers triggered by asymmetric information issues.

This paper focuses on the problem of real estate agents' disloyalty to their clients (buyers or sellers) caused by asymmetric information, and introduces several previous studies from the US which we compare to our research on the effects of dual agency deals in Japan. Dual agency is the representation of both seller and buyer by the same agent in a housing transaction. Furthermore, the paper questions whether accepting dual agency in housing transactions is ethical.

2. Information Failure in the Existing House Market

The asymmetric information problem in the existing house market can occur in two basic situations. Firstly, it happens where buyers have less knowledge of the quality of the house than sellers do; the problem of hidden characteristics and adverse selection. Secondly, it happens when principals (buyers or sellers) are not able to monitor the agents' behavior; the problem of hidden actions and moral hazard.

In typical housing transactions, sellers have more information about the houses than buyers do; the information contains not only the condition of the house that is visible or invisible on the surface, but also transaction history such as the sale price of past transactions. In a market with asymmetric information, the willingness to pay of buyers exposed to risk of purchasing "lemons" could be low, and the sellers providing high-quality houses would withdraw from the market. Only poor-quality houses are left, as a result, and the market would shrink. In the case of the problem of hidden characteristics, real estate brokers with abundant experience and knowledge of house trading are helpful to buyers worrying about unfair trades, and contribute to preventing the market from being lemon-ized.

Intentionally hidden actions of real estate agents are a moral hazard, while the adverse selection problem occurs without the will of the market participants.

Dual Agency versus Single Agency

In housing transactions, the term "dual agency" indicates that a real estate broker represents both seller and buyer in the same transaction, which could cause a conflict of interest; the buyer (seller) generally wants to buy (sell) the house at lowest (highest) price, but the dual-agent owes a fiduciary duty to both principals in the same deal. On the other hand, "single agency" means that an agent will represent the interests of either seller or buyer but not both clients in the same transaction. In other words, the single-agent will represent only one side and have loyalty to his client. This relationship between brokers and clients in real estate is one of the most common in the US.

Even in single agency, however, real estate agents have the incentive to betray their client's benefit; the agents are more willing than their principals to accept undesirable price in order to reduce trading time (Levitt and Syverson 2008; Rutherford et al. 2005, Hendel et al. 2008). In addition, Kadiyali et al.(2014) indicates that dual agency further distorts the agent's incentives and his behaviors in three ways. First, the agent has an incentive to steer buyers to his own listings (sellers), or to steer sellers to his own buyers rather than alternative buyers (clients of competing brokers) with willingness to pay higher prices. Second, the agent could disclose confidential information to only one of his clients, either buyer or seller, helping one in either the search or negotiation phase of the trading process. Third, to hasten the sale, the agent may pressure the buyer (seller) to accept a higher (lower) price in the negotiation phase.

Therefore, allowing dual agency could distort the price mechanism in the market of existing houses, and could incentivize the agent to breach his fiduciary duties; the agent tends to stand by either buyer or seller depending on the situation². The related problem has been

arising recently in Japan; it is called “Kakoikomi” meaning that a seller’s agent hides the existence of other potential buyers (clients of competing agents) from sellers. For example, when a competing agent for buyer A (offering the best value) contacts a seller’s agent, the seller’s agent provides a false report, such as “the house is sold” or “it is under negotiation.” He then tries to sell the house to his own buyer B (or tries to find another buyer, C, by himself) in order to earn commissions from both buyer and seller from the same transaction, despite buyer B or C’s offering price being lower than buyer A’s. The “Building Lots and Buildings Transaction Business Act” prohibits this “Kakoikomi,” but it is difficult for clients and regulatory administration to monitor agents’ hidden actions.

3. Regulation and Ethics Code of Real Estate Industry Organization

In the US, state law limits dual agency deals in order to prevent real estate brokers’ moral hazard. That is, several states prohibit the dual agency deal while others permit it with several types of restriction³. A few states, such as Colorado and Maryland, permit within-branch (within-company) agency, in which two agents for both buyer and seller work at same branch (at different branches of the same company), but prohibit dual agency where the same agent represents both buyer and seller. This brokerage relationship is called designated agency. However, in designated agency, two agents from the same company could patronize either buyer or seller; therefore, this type of restriction does not seem effective enough for preventing the moral hazard problem.

As mentioned above, the dual agent has incentives to represent one client to the exclusion of the other, for example, giving confidential information to either buyer or seller, in order to be certain to close a deal. However, if both clients know the dual agency status before agency agreement or negotiation, it would be difficult for the agent to provide advantages to only one side. Several states, such as Hawaii and New York, require dual agents to disclose the dual agency status to both buyers and sellers. The type of disclosure requirement for dual agency varies across states, for example, some states require that agents obtain written acknowledgment of the dual agency status from clients, while other states only require a verbal disclosure. Punitive nullification of operating licenses guarantees the effectiveness of the state law.

In addition to state law, the professional ethos of the US National Association of Realtors, NAR, requires dual agency disclosure. This organization is one of the largest trade associations, with approximately 1.2 million members, which the residential and commercial real estate industry, belongs to, as of November 2017. The Code of Ethics and Standards of Practice of NAR states “Realtors may represent the seller/landlord and buyer/tenant in the same transaction only after full disclosure to and with informed consent of both parties (Standard of Practice 1-5).”

In Japan, on the other hand, the law prohibits real estate brokers from intentionally hiding

2 Dual agency also has the benefit of efficient transactions; it could save time in matching buyers with sellers, and in negotiating.

3 Olazabal (2003) explains various types of agency relationships in real estate precisely and extensively (see Appendix).

Table 1. A Comparison between Dual Agency and Single Agency Deals in Long Island, New York

	Dual Agency	Single Agency
Sales Price (\$)	570,957	566,841
List Price (\$)	603,003	591,381
Time-to-Sale (days)	82.0	84.2
# of Samples	5,247	5,641

Source: Kadiyali et al.(2014) p.178

Note: About half (48%) of all transactions occurred via dual agency; dual-agent deals (26%), within-branch deals (19%), and within-agency deals (3%).

information related to the housing transaction from their clients, but there are no restrictions on dual agency deals by law or any codes of ethics.

4. The Effect of Dual Agency on Housing Transactions

Gardiner et al. (2007) examined the effect of a law change in Hawaii. The State of Hawaii mandated real estate brokers to disclose the fact of dual agency to both seller and buyer before agency agreements in 1984. The study compared the housing transaction data of price and time, pre-regulation (1,989 data in the period 1977–1980) and post-regulation (1,858 data in the period 1987–1989). They found that dual agency reduced the sale price, but the effect was much smaller after the introduction of the new legislation (8.0% versus 1.4%). In addition, dual agency reduced the time of the transactions by about 8.5 % pre-legislation and 8.1 % post-legislation.

Evans and Kolbe (2005) look at the dual agency effect on housing prices using the data of 4,151 houses traded more than once during 1997–2003 in Memphis, Tennessee. They found that in the first transaction, dual agency had no impact on price, but in the second, it had a negative effect.

Kadiyali et al. (2014) conducted regression analysis, with the dependent variable being the actual transaction price, using 10,888 datasets of houses traded during 2004–2007 in Long Island, New York, and found that dual agency had no net effect on sale prices (Table1). They carried out further regression analysis, adding list price as an independent variable, and explained the lack of effect of dual agency on the sales price as the combination of two countervailing effects. The first is agents exploiting information on internal buyer clients’ preferences and willingness to

Table 2. The Relationship between Real Estate Brokers and Clients in Japan

	(N=155)
Single agency only brokers	19.4%
Single/Dual agency brokers	64.5%
Dual agency only brokers	16.1%

Source: Shirakawa and Okoshi (2017)

Note: We class the groups of brokers by the levels of commission earned in one transaction.

Single agency only broker: less than 3% of the sale price

Single/Dual agency brokers: 3% or more, but less than 6% of the sale price

Dual agency only brokers: 6% or more of the sales price

pay to help seller clients set a higher list price and ultimately obtain a higher sale price. The second is agents favoring the buyer over the seller in the negotiation phase. New York only permits dual agency when the agent makes full and complete disclosure to and obtains written acknowledgement from both clients. This is also the case in several other states, such as Hawaii mentioned above, and therefore the null effect seems to be a consequence of disclosure regulation.

From the results of previous studies examining the influence of dual agency in the US, we see that the difference in sale price between dual agency and single agency could disappear, especially under sufficient disclosure. The disclosure rule could also work as a deterrent against the agent's moral hazard.

The Case of Japan

In Japan, we have rarely conducted quantitative studies about the relationship between real estate agents and clients and the behavior of housing market participants. Therefore, the picture of the effect of dual agency is not clear. The crucial reason for the lack of studies is the difficulty in gaining access to a comprehensive database of housing transactions, the likes of US MLS⁴.

Our study (Shirakawa and Okoshi, 2017) attempted to analyze the effect of dual agency on housing transactions in Japan employing the data of questionnaire research on real estate brokers' behavior⁵. We calculated the share of real estate brokers introducing dual agency from the questionnaire data and found that approximately 81% of brokers employed dual agency deals. The share of single-agency-only companies was 19% (Table 2). This estimation indicates that dual agency is the most common deal method in Japan.

We carried out regression analysis to examine the impact of dual agency on house prices, the dependent variable was the average housing transaction price of each broker, and the independent variables were group dummies as follows: the first is the "single-agency-only" group, the second is the "single or dual agency" group, and the third is the "dual-agency-only" group. Table 3 shows the result of the analysis; and we find that the coefficients of "single or dual agency" and "dual-agency-only" are significantly negative. We can see that dual agency significantly reduces the housing price in the existing house market in Japan. This result indicates that dual agency could be a disadvantage for sellers in Japan where the population is decreasing, however, the opposite is possible in growing areas where the dual-agent holds more buyers than sellers as his own clients.

4 Multiple Listing Service (MLS) is a service used by a group of real estate brokers, and it allows each of them to see another's listings of properties for sale. MLS creates an electronic database of the houses for sale and those sold before. The database consists of abundant information about houses, such as owner, location, tax, characteristics, estimated value, market conditions, mortgage history, foreclosure history, property map, neighbor details etc.

5 The Land Institute of Japan carried out a questionnaire survey of real estate brokers to find out whether the existing house market had grounds for working healthily in Japan. One thousand questionnaires were mailed to real estate brokers across the country during January-February of 2015, and 247 (24.7%) valid responses were received.

Table 3. The Relationship between Real Estate Brokers and Clients in Japan
(N=155)

	model 1		model 2	
	coef	SE	coef	SE
Intercept	53701313***	8255161	42861517***	9185982
Dummy of agency-type				
Single agency only	(base group)	-	(base group)	-
Single/Dual agency	-23162140*	9412332	-23562684*	9354495
Dual agency only	-35090935**	12244382	-33310281**	12185069
Dummy of # of employees				
1-5			(base group)	-
6-10			6905144	7689762
11-			12149065	15414726
Dummy of location				
Big city area			15567036*	7375346
Non-big city			(base group)	-
R ²	0.05658		0.09767	
Adjusted R ²	0.04417		0.06739	

***: p<0.01, **: p<0.05, *: p<0.1

Source: Shirakawa and Okoshi (2017) p.96

5. Conclusion

The price difference between dual and single agency disappears in the US where real estate brokers employing dual agency deals are required to disclose dual agency status. On the other hand, our research found that dual agency had the effect of reducing the sale price of houses in Japan since there are no restrictions on dual agency that could highlight the conflict of interests.

Revitalization of the existing house market is a pressing issue in our country where we face a decreasing population and an increase in vacant houses, and yet the size of the market is quite small compared to other advanced countries. One of the reasons for the small market might be the deep mistrust of real estate brokerages. The most common relationship between real estate brokers and clients is dual agency, which would be an incentive for real estate agents to act disloyally to their principals and bring disadvantage to either the house seller or buyer. The question arises whether dual agency in housing transactions is ethically acceptable. Prohibiting dual agency seems an excessive response, because it has the benefit of efficient transactions and sometimes the market participants might only be interested in selling time. The important point is that dual agency distorts market prices, that is, it causes information failure. We therefore recommend the enactment into law or the ethical codes of Japanese real estate industry, certain restrictions, such as the US disclosure requirements of dual agency status.

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Is Dual Agency in Housing Transactions Ethically Acceptable?

Appendix. Classification of States by Realtor Roles, Default Position, and Other-Party Duties (Olazabal, 2003)

Alabama	IV	C	4	Montana	IV	A	3
Alaska	I	B	1	Nebraska	I	A	3
Arizona	I	B	3	Nevada	II	B	4
Arkansas	I	B	2	New Hampshire	IV	A	3
California	I	B	4	New Jersey	IV	A	3
Colorado	IV	A	3	New Mexico	IV	C	3
Connecticut	II	B	2	New York	I	B	4
Delaware	I	B	3	North Carolina	II	A	3
Florida	IV	B	3	North Dakota	II	A	3
Georgia	IV	A	3	Ohio	II	B	3
Hawaii	I	B	1	Oklahoma	IV	C	2
Idaho	III	A	4	Oregon	II	B	4
Illinois	III	B	3	Pennsylvania	IV	C	4
Indiana	III	A	3	Rhode Island	I	A	2
Iowa	III	A	4	South Carolina	I	A	2
Kansas	IV	A	3	South Dakota	IV	A	3
Kentucky	IV	B	2	Tennessee	IV	C	4
Louisiana	III	A	2	Texas	II	B	2
Maine	II	B	3	Utah	I	A	1
Maryland	I	A	3	Vermont	I	A	3
Massachusetts	I	B	2	Virginia	II	B	3
Michigan	IV	B	1	Washington	II	A	4
Minnesota	IV	B	3	West Virginia	I	B	4
Mississippi	I	B	3	Wisconsin	III	A	4
Missouri	IV	A	3	Wyoming	IV	A	3

Source: Olazabal (2003) p.132

Note:

Realtor Roles

Type I: recognize buyers' brokers
 Type II: add designated agency
 Type III: two-tiered service
 Type IV: add transaction brokers

Realtor Roles

Class A: traditional model
 Class B: "choice"/traditional model
 Class C: transaction broker default

Other-Party Duties

Cat. 1: nonenumerated
 Cat. 2: honesty/good faith
 Cat. 3: disclose material adverse facts
 Cat. 4: include reasonable care

