

# 13

## The Brokerage Business

### Function and Organization

### The Broker-Salesperson Relationship

### Operating a Real Estate Brokerage

### Business Brokerage

### Syndications and Securities Brokerage

---

#### FUNCTION AND ORGANIZATION

#### The core activity of brokerage

#### Who may legally broker real estate?

#### Types of brokerage organization

#### Trade organizations

---

#### The core activity of brokerage

**Effecting a transaction.** The core activity of real estate brokerage is the business of procuring a buyer, seller, tenant, or property on behalf of a client for the purpose of completing a transaction. If successful, the broker receives a commission according to the provisions of a listing agreement. A broker's compensation for effecting a transaction is usually a negotiated percentage of the purchase price.

**Broker cooperation.** In most cases, transactions require the assistance of a cooperating broker from another brokerage company acting as a subagent. Most listing agreements provide for brokerage cooperation in the multiple listing clause. A transaction involving a cooperating subagent is called **co-brokerage**. In a co-brokered transaction, the listing broker splits the commission with the "co-broker," typically on a 50-50 basis. A broker may cooperate with other brokers on either side of a transaction, either assisting a listing agent to locate a buyer or tenant, or assisting a buyer or tenant representative in locating a seller or landlord.

In the most common form of broker cooperation, an outside broker locates a buyer for the listing broker's seller. In such cases, the listing broker shares the commission with the cooperating "selling" broker on a pre-determined basis.

**Multiple listing service (MLS).** The second prevalent form of broker cooperation is the multiple listing service, or MLS. A multiple listing service is an organization of brokers who have agreed to cooperate with member brokers in marketing listings. Members of the service also agree to enter all exclusive listings into the listing distribution network so that every member is promptly informed of new listings as they come on the market.

The listing agreement used by members of a multiple listing service discloses relevant procedures and policies so that all principal parties to the agreement are aware of the pooling of the listing. A broker who works on a transaction listed in

the MLS has all the duties and responsibilities inherent in the laws of agency as the client's fiduciary agent. The listing agreement sets forth specific duties.

**Critical brokerage skills.** To generate business, as well as achieve the transactional objectives of clients, a broker must be proficient in four skill areas:

- ▶ obtaining a client listing
- ▶ marketing a listing
- ▶ facilitating the closing of a transaction
- ▶ managing market information

A client hires a broker by executing a listing agreement. Once hired, the broker or agent implements a marketing plan to procure the other principal party for the transaction. The broker then plays an important role in pre-closing activities to ensure successful closing of the transaction.

To serve clients and locate customers, a broker must become expert in local real estate market conditions. A fundamental part of maintaining market expertise is organizing and managing an information system.

**Types of transactions and properties brokered.** Brokers and salespeople are licensed to broker all types of real property for clients in any form of transaction. In practice, it is common for brokers and agents to specialize in a type of property, a type of transaction, or a geographical area.

**Brokerage vs. trading.** The distinction between brokerage and trading for one's own account is important for determining whether one must be licensed to perform the real estate activity in question. To be considered brokerage, an agent's activity must generally be conducted on behalf of a person or business entity other than the agent. Buying, selling, and leasing real estate for one's own account or for one's company are generally not considered brokerage.

**Brokerage vs. advisory services.** Technically, brokerage is distinct from the practice of rendering real estate advisory services. A licensed broker acting as a consultant for a fee usually is not working to effect a particular transaction. Since the objective is not purely transaction-oriented, the activity is not really brokerage. Examples of advisory services include:

- ▶ providing an estimate of value
- ▶ performing market analysis
- ▶ managing property

Even though fee consulting is not brokerage in the strict sense, real estate consultants who offer advisory services to the public must have a real estate license in most states.

### Exhibit 13.1 Common Brokerage Specialties

Transaction type	
sales rentals assignments	exchanges subleases options
Property type	
<b>Residential</b>  single family condominiums cooperatives mobile homes apartments	<b>Commercial</b>  retail office industrial
<b>Land</b>  undeveloped developed agricultural	<b>Special purpose</b>  government religious recreational
<b>Businesses</b>	<b>Real estate securities</b>

**Who may legally broker real estate?**

**Real estate license laws.** All fifty states (and Canada) impose legal licensing requirements on any person or business entity desiring to broker real estate. To obtain a broker's license, an applicant must complete required education, meet experience requirements as a salesperson, and pass a state examination. There may be additional requirements concerning age, criminal record, and professional background. Practicing real estate brokerage without a valid license is illegal. Anyone who plans to obtain a real estate license should become familiar with the real estate license law of the relevant state.

**Range of business entities.** Some business entities may legally broker real estate, and others may not. The principal types of business organization and the legal restrictions on their ability to broker real estate are described below. Note that all the business entities may own, buy, and sell *their own* real estate in varying degrees without violating license laws.

**Sole proprietorship.** A sole proprietorship is a business owned by a single individual. When the proprietor dies, the business terminates. Sole proprietorships must follow state licensing and registration laws to conduct business, such as fictitious name laws. Other distinguishing characteristics of sole proprietorships are:

- ▶ liability: sole proprietors are personally liable for their own debts and actions and those of employees while performing business duties; proprietors may be sued personally

- ▶ taxation: business profits are taxed once as the proprietor's personal income

A sole proprietorship *may broker* real estate if properly licensed.

**Corporation for profit.** A corporation is a legal entity owned by stockholders. A corporation for profit consists of one or more persons authorized to conduct business for profit. A board of directors elected by stockholders oversees the business. Officers (president, vice president, secretary, treasurer) and managers conduct day-to-day affairs. Other distinguishing characteristics are:

- ▶ "perpetual" existence: the corporation survives the death of any of the stockholders, directors, or officers
- ▶ formation: to incorporate, principal parties must complete and file articles of incorporation in accordance with state law; a corporation is domestic if it is headquartered in the state where the articles of incorporation were filed. Otherwise, the corporation is a foreign corporation
- ▶ liability: shareholders of the corporation are only liable to the extent of the value of one's shares; officers and directors may be held personally liable for the corporation's actions under the Sarbanes-Oxley Act of 2002
- ▶ taxation: owners are double-taxed on business profits; corporate profits are taxed and after-tax dividends distributed to shareholders are taxed again as personal income

A corporation *may broker* real estate if it is legally authorized to do business in a state and licensed to broker there. State license laws may require one or more officers to hold active or inactive broker's licenses. Generally, shareholders may not broker real estate for the corporation.

**Non-profit corporation.** A non-profit corporation is a corporate entity which is not legally entitled to generate profit. A board of directors and officers manage operations. Non-profit organizations are not subject to taxation.

A non-profit organization *may not broker* real estate.

**General partnership.** A general partnership is a for-profit business consisting of two or more co-owners who have agreed to share business profits. Unlike a corporation, the general partnership is not a distinct, legal entity, although a corporation may be a partner in a general partnership. Additional distinguishing features are:

- ▶ formation: the partnership is formed by a written or oral partnership agreement with or without a financial investment by either partner
- ▶ dissolution: the partnership may be terminated through mutual agreement, withdrawal or death of a partner, or by legal action
- ▶ liability: all partners bear full liability for debts and obligations jointly and severally
- ▶ taxation: partners are taxed once on their respective partnership profits; partnerships do not have double-taxation

A general partnership *may* broker real estate if properly licensed. State law may require one or all partners to hold active or inactive broker's licenses.

**Limited partnership.** A limited partnership consists of general partners and limited partners. General partners are wholly responsible for business operations, while limited partners are investors who participate only in business profits. The general partners typically receive compensation for their management responsibilities. Other defining features are:

- ▶ limited partners: a limited partner must make an investment, which subsequently comprises the extent of the partner's liability. Limited partners are taxed once, on profits distributed by the partnership.
- ▶ general partners: bear sole liability for debts and obligations

A limited partnership *may* broker real estate. However, limited partners may not broker real estate for the partnership. State laws may require the general partners to have active or inactive broker's licenses. Limited partners need not be licensed for the partnership to broker real estate.

**Joint venture.** A joint venture is a partnership formed to complete a specific business endeavor, such as a real estate development. Individuals, general and limited partnerships, and corporations may participate. In forming the entity, the partners identify how they will conduct business and share profits. Principal parties in the joint venture share liability, but may not obligate the other co-venturers to agreements outside of the joint venture project.

A joint venture *may* broker real estate, provided the co-venturers are duly licensed.

**Business trust and real estate investment trust.** A business trust is a group of investors who invest in a pooled trust fund managed by their elected trustee. The trustee purchases investment assets and distributes profits and gains to the trustors. A business trust that invests primarily in real estate and meets certain other requirements is a real estate investment trust (REIT) and receives special tax treatment.

A business trust may *not* broker real estate, but it may buy and sell its own real estate assets.

**Cooperative association.** A cooperative association is a non-profit, tax-exempt alliance of individuals or companies formed to promote common goods or services.

A cooperative association *may not* broker real estate.

### Exhibit 13.2 Who may broker real estate

May broker	May not broker
individual sole proprietor for-profit corporation general partnership limited partnership joint venture	non-profit corporation business trust co-operative association

### Types of brokerage organization

In addition to being organized as a sole proprietorship, partnership, corporation or joint venture, a brokerage may be:

- ▶ independent or affiliated
- ▶ specialized in a type of property
- ▶ specialized in a type of transaction
- ▶ specialized in a type of client

These variations in brokerage organization are usually a response to competitive conditions in the local real estate market.

**Independent brokerage.** A brokerage that is not affiliated with a franchise is an independent agency. Many independent agencies participate in networks on a local, regional, or national basis. Such networks expose the independent broker to a larger market without compromising individual identity.

**Franchise.** A franchised brokerage is an independently-owned company that enters into a licensing arrangement with a franchisor to participate in various benefits offered in exchange for compensation. Franchisors generally offer local franchisees:

- ▶ the use of a recognized trade name
- ▶ national and regional advertising
- ▶ training programs
- ▶ standardized operating procedures
- ▶ a national referral system

In exchange, a franchisee pays the franchisor start-up fees and a portion of gross income.

**Commercial and residential brokerages.** Many brokerages deal primarily with limited types of property: residential, commercial, industrial, undeveloped land, etc. In practice, most residential companies conduct a small amount of commercial brokerage, while commercial brokerages tend to deal strictly with retail, office, industrial, or land properties. A large company may handle all types of properties but will probably have a separate organizational division for each property type.

**Transaction-specialized brokerages.** Brokerages often organize around a particular type of transaction. Thus, there are companies that specialize in apartment rentals, office rentals, exchanges, business brokerage, and, most commonly, residential sales.

**Buyer- and seller-oriented brokerages.** Companies sometimes specialize even further by choosing to represent only one side in a transaction. Thus a brokerage may represent only commercial tenants, or only residential buyers, or some other limited type of client.

## Trade organizations

Numerous trade organizations serve the real estate brokerage industry and all of its areas of specialization. The largest is the National Association of Realtors® (NAR). NAR is comprised of a national headquarters, a state association in each state, and within each state, local Realtor® boards.

One should note that the term Realtor® is a protected trade name of NAR. *Only members of the organization may use the term to refer to themselves.* More specifically, there are two identities within NAR: Realtor, and Realtor-Associate. By definition, a Realtor® is a member broker and a Realtor-Associate® is a member sales agent. (In some states, Realtor applies to both broker and sales agent.) Membership in the local board automatically includes membership in the local MLS, the state association, and NAR.

---

## THE BROKER-SALESPERSON RELATIONSHIP

### Legal relationships Salesperson's employment status Obligations and responsibilities Agent compensation

---

**Legal relationships** Only a broker with an active broker's license can hire and employ a licensed salesperson. A licensed salesperson may work only for the employing broker and may not work for or receive direct compensation from any other broker.

**Agent's scope of authority.** State real estate license laws provide for two distinct licenses to conduct real estate brokerage: the broker license and the salesperson or sales agent license.

A licensed real estate broker is duly authorized to represent clients directly in brokering real estate. A sales agent, on the other hand, is only authorized to represent a broker and carry out such duties as the broker may legitimately delegate. In other words, a sales agent does not directly represent the client in a transaction but is rather the agent of the broker and subagent of the client. A sales agent is therefore a fiduciary of the employing broker.

As agent of a broker, a salesperson may offer properties for sale or lease, procure buyers, negotiate transaction terms, and otherwise conduct the business of brokerage. The agent, however, must act entirely on the broker's behalf.

A salesperson *may not*:

- ▶ bind a client to any contract
- ▶ receive compensation directly from a client
- ▶ accept a listing or deposit that is not in the name of the broker

## Salesperson's employment status

A sales agent may be an independent contractor (IC) or an employee. In either case, the broker is responsible and liable for the sales agent's actions. Brokers are subject to guidelines of the U.S. Equal Employment Opportunity Commission (EEOC), a federal agency that enforces laws against workplace discrimination.

**Independent contractor / broker relationship.** Generally, a broker has limited control over the actions of a contractor. Specifically:

- ▶ a broker can require performance results, but is limited in demanding *how* a contractor performs the work. For example, a broker may not prescribe selling methods, meeting attendance, or office hours.
- ▶ an IC is responsible for income and social security taxes; the broker does not withhold taxes
- ▶ a broker cannot provide an IC with employee benefits such as health insurance or pension plans

**Employee / broker relationship.** A broker has greater control over the actions of an employee. Specifically:

- ▶ a broker can impose a sales methodology. In addition, a broker can enforce all office policies, including hours, meeting attendance, and telephone coverage.
- ▶ a broker must withhold income taxes and pay unemployment compensation tax on behalf of an employee
- ▶ an employee may receive the benefits enjoyed by the broker's non-selling employees

A written agreement between broker and employee or independent contractor should clearly state each party's duties and responsibilities to the other. In addition, the agreement should clarify the agent's compensation program as well as who is to pay for incidental business expenses.

## Obligations and responsibilities

**Sales agent's duties and responsibilities.** In accepting employment from a broker, a salesperson generally makes a commitment to:

- ▶ work diligently to sell the broker's listings
- ▶ work diligently to procure new listings
- ▶ promote the business reputation of the broker
- ▶ abide by the broker's established policies
- ▶ fulfill the fiduciary duties owed clients as their subagent
- ▶ maintain insurance policies as required by the broker
- ▶ have transportation for conducting business, as required by the broker

- ▶ conform to ethical standards imposed by broker and trade organization
- ▶ uphold all covenants and provisions of the employment agreement

**Broker's obligations to the sales agent.** In employing a salesperson, a broker generally makes a commitment to:

- ▶ make the brokerage's listings available
- ▶ make the brokerage's market and property data available
- ▶ provide whatever training was promised at the time of hiring
- ▶ provide whatever office support was promised at the time of hiring
- ▶ uphold the commission structure and expense reimbursement policy
- ▶ conform to ethical standards imposed by the broker's trade organization
- ▶ uphold all covenants and provisions of the employment agreement

**Agent compensation** An agent employee of a broker may receive wages, salary, additional commissions, expense reimbursements, and benefit plans. An independent contractor's compensation is normally a combination of commissions and free office support. Most sales agents work as independent contractors who earn a commission.

**Commission splits.** A sales agent earns compensation for procuring listings and for procuring buyers or tenants, whenever a transaction results. In the jargon of brokerage, these are the two "sides" to a commission: the listing side and the selling side. An agent who procures a listing receives a share of the broker's listing side commission, according to the agent's commission schedule. An agent who sells a listing, i.e., finds the customer, receives a share of the broker's selling side of the commission, according to the commission schedule. An agent who procures both listing and customer receives a share of the broker's listing side commission and selling side commission.

**Commission schedules.** An agent's commission schedule is a comprehensive summary of commission splits under various circumstances, including:

- ▶ listing and selling side
- ▶ salesperson's level of sales performance
- ▶ broker's level of expense reimbursement to agent
- ▶ the particular policies or organization of the agency
- ▶ prevailing commission splits in the market

In view of these circumstances, an agent's commission schedule can vary widely. For example, an agent who is the highest sales producer in the market may be able to secure a 70% or 80% commission split with the broker, regardless of side. If the broker is paying an inordinate amount of selling expenses, an agent's commission split may only be 40%. Some brokerages have a policy of not paying any expenses except the rent. In such cases, agents may receive an 80% or 90% commission split. In almost all cases, broker and agent negotiate the schedule of commissions in the environment of competitive market conditions.

**Calculating commissions.** The following exhibit illustrates how commissions might be split in a hypothetical transaction.

## Exhibit 13.3 Calculating Commissions

Sale price: \$100,000                      Co-brokerage splits: 50%  
Commission: 6%, or \$6,000      Agent splits: 50% on both  
sides

Situation A: a cooperating broker is involved

	Commission \$	Commission %
Listing broker	1,500.	1.5%
Listing agent	1,500.	1.5%
Selling broker	1,500.	1.5%
Selling agent	1,500.	1.5%

Situation B: no cooperating broker; listing agent finds buyer

Listing broker	3,000.	3.0%
Listing agent	3,000.	3.0%

Situation C: no cooperating broker; another agent *in the same agency*  
finds buyer

Listing broker	3,000.	3.0%
Listing agent	1,500.	1.5%
Selling agent	1,500.	1.5%

---

### OPERATING A REAL ESTATE BROKERAGE

Obtaining listings  
Marketing listings  
Pre-closing activities  
Managing information  
Policy manual  
Advertisement regulations  
Anti-trust laws

---

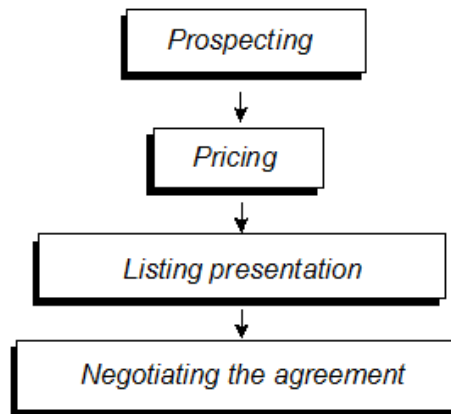
#### Obtaining listings

Listings are the traditional source of a broker's income. By obtaining a listing, a broker obtains a share of the commission generated whenever a cooperating broker finds a buyer. It is not so certain that working with a buyer will provide income. In the absence of an exclusive buyer representation agreement, a buyer may move from one agent to another without making any commitment. Agents can spend considerable time with a buyer and earn nothing. Hence the special value of a listing: it is likely to generate revenue.

**Listing procedures.** The marketing and self-promotional efforts of agents generate listings. New agents usually focus on becoming well known in a small geographical area and hope to encounter clients there who are willing to list with them. More experienced and better-known agents are able to rely to a greater extent on referrals in obtaining listings.

New or experienced, an agent needs certain skills at each step in the process of obtaining a listing.

### Exhibit 13.4 Listing Steps



**Prospecting.** Prospecting is any activity designed to generate listing prospects: parties who intend to sell or lease property and who have not yet committed to a broker. Prospecting activities include mailing newsletters and flyers, selling directly and person-to-person, advertising, and selling indirectly via community involvement.

The goal of prospecting is to reach a potential seller or landlord, make that person aware of the agent's and brokerage's services, and obtain permission to discuss the benefits of listing, often in the form of a formal selling presentation.

**Pricing.** It is almost always necessary for an agent seeking a listing to suggest a listing price or price range for the property. It is important to make a careful estimate, because underpricing a property is not in the best interests of the seller, and overpricing it often prevents a transaction altogether.

The "Appraisal" chapter describes methods of estimating value. In brief, an agent usually relies on an analysis of comparable properties which have recently sold in the same neighborhood. By making adjustments for the differences between the subject property and the comparables, the agent arrives at a general price range.

Agents must be careful to caution sellers that they are not appraisers, and that the suggested price range is not an expert opinion of market value. If a more precise estimate of market value is desired, the seller should hire a licensed appraiser.

**Listing presentation and negotiation of agreement.** A listing presentation is an agent's opportunity to meet with a seller and present the merits of the agent's marketing plan, personal expertise, and company strengths. At the same time, an agent can explain the many phases and details of a real estate transaction and point out how the provisions of the listing agreement and the agent-principal relationship work to ensure a smooth transaction.

Ultimately, the agent's aim in a presentation meeting is to have the principal execute a listing agreement. The agent must then submit the listing to the broker for approval and signing. This result will set in motion the process of marketing the property. In practice, it may take an agent many meetings with a prospect before the prospect signs an agreement.

## Marketing listings

The process of marketing a listed property occurs in three broad steps, leading to the desired end of a completed sale contract. At each of these steps, there are critical skills an agent must master.

### Exhibit 13.5 Marketing Steps



**Marketing plan.** After the broker formalizes the listing agreement, the sales agent initiates a marketing plan for the property. An ideal marketing plan is a cohesive combination of promotional and selling activities directed at potential customers. The best combination is one that aims to have maximum impact on the marketplace in relation to the time and money expended.

**Selling the prospect.** When marketing activities produce prospects, the agent's marketing role becomes more interpersonal. An agent must now:

- ▶ qualify prospects' plans, preferences, and financial capabilities
- ▶ show properties that meet the customer's needs
- ▶ elicit the buyer's reactions to properties
- ▶ report material results to the seller or listing agent

At the earliest appropriate time, an agent must make certain disclosures to a prospective customer. Depending on state laws, an agent may have to disclose the relevant agency relationship, the property's physical condition, and the possible presence of hazardous materials.

**Obtaining offers.** If a buyer is interested in purchasing a property, an agent obtains the buyer's offer of transaction terms, including price, down payment, desired closing date, and financing requirements.

An agent must be extremely careful at this point to abide by fiduciary obligations to the client, whoever that party may be. Discussions of price are particularly delicate: whether the client is buyer or seller, the agent's duty is to uphold the client's best interests. Thus it is not acceptable to suggest to a customer what price the client will or will not accept. With pricing and other issues, it is always a good practice to understand what role the client wants the agent to assume in the offering phase of the transaction; in other words, exactly how far the agent may go in developing terms on the client's behalf.

When a buyer or tenant makes an offer, the agent *must* present it to the seller or landlord at the earliest possible moment. If the terms of the offer are unacceptable, the agent may assist the seller in developing a counteroffer, which the agent would subsequently submit to the customer or customer's agent. The offering and counteroffering process continues until a meeting of the minds results in a sale contract.

**Pre-closing activities** Between the execution of the sale contract and the closing of the transaction, the property is "under contract" or "contract pending." During this period, buyer and seller have certain things to do to achieve a successful closing. The buyer often needs to arrange financing and dispose of other property; the seller may need to clear up title encumbrances and make certain property repairs. The sale contract should specify all such required tasks.

The time period between contracting and closing is referred to as the **contingency period**, or **pre-closing period**.

**Agent's responsibilities.** As dictated by custom and the circumstances of a transaction, an agent has a range of duties and responsibilities during the pre-closing period.

An agent's foremost duty following acceptance of an offer is to submit the contract and the earnest money to the employing broker without delay. Most states impose deadlines for this requirement, usually within twenty-four hours from the agent's receipt of the deposit.

Other possible responsibilities are:

- ▶ assisting the buyer in obtaining financing
- ▶ assisting the seller in clearing title
- ▶ assisting the seller in completing property repairs
- ▶ recommending inspectors, appraisers, attorneys, and title companies
- ▶ assisting in communications between principals
- ▶ assisting in the exchange of transaction documents

**Broker's responsibilities.** The listing broker has the primary responsibility for handling deposit monies and for overseeing the agent's pre-closing activities. State license laws require that earnest money deposits be placed in an account which is separate from the broker's operating accounts. They also require the broker to keep accurate records and follow accepted accounting procedures. These precautions protect the buyer and seller and safeguard the deposited funds. A broker must be careful to avoid two common violations of escrow regulations: commingling and conversion.

## Managing information

**Commingling.** Commingling is the act of mixing the broker's personal or business funds with escrow funds. A broader definition of commingling includes the failure to deposit earnest money into escrow in a timely manner. In most states, commingling funds constitutes grounds for license suspension or revocation.

**Conversion.** Conversion is the act of misappropriating escrow funds for the broker's business or personal use. More serious than mere commingling, conversion is effectively an act of theft: using monies which do not belong to the broker. Conversion carries serious consequences, including license revocation.

The ability to satisfy the needs of clients and customers is largely dependent on a broker's ability to obtain, organize, and manage information. Information is a cornerstone of the broker's perceived value in the marketplace and a major reason why buyers and sellers seek a broker out. Systematic collection and updating of relevant information is therefore a business priority.

**Property data.** Most brokerages maintain two categories of property data: available properties, and all properties in the market area. In residential brokerage, available property basically consists of the listings in the MLS and for-sale-by-owner properties. Records for all properties in an area are accessible in tax records. Commercial brokerages usually keep track of available and occupied commercial properties in a proprietary database.

**Buyer data.** Buyer information is usually compiled and maintained, often informally, by each agent in a brokerage. An agency's base of prospects who are looking for property at any given time is valuable for marketing new listings.

**Tenant data.** In residential and commercial leasing companies, information is compiled and maintained on all tenants in an area, by property type used. Such files contain a tenant's lease expiration, property size, and rent.

**Client data.** It is important to keep track of both current and former clients. Former clients are likely prospects to become clients again or customers. They are also a source of referrals. Current clients, of course, should be the broker's primary concern.

**Market data.** Today's clients and customers expect a broker to know the market intimately. It is often the broker or agent with the best market knowledge who dominates business in the market. Knowing a market includes keeping up to date on:

- ▶ pricing and appreciation trends
- ▶ financing rates and terms
- ▶ demographic patterns and trends
- ▶ construction trends
- ▶ general economic trends

## Policy manual

A well-managed brokerage relies on a written policy manual to keep the business running smoothly and professionally. A policy manual sets forth company rules, regulations, and policies.

## Advertisement regulations

Advertising is an important tool in marketing properties and procuring buyers. It is, however, subject to regulation and restrictions. In general, state laws and regulations require that:

- ▶ advertising must not be misleading
- ▶ the broker is responsible for the content of advertising done by agents
- ▶ all advertising must reveal the identity of the broker; licensed brokers and agents may not use blind ads that conceal their identities
- ▶ brokers selling their own property through the brokerage must disclose the brokerage identity
- ▶ salespersons must include the broker's business identity in any advertising; they may not advertise in their own name solely (unless selling their own property through channels other than the agency)

**Telephone Consumer Protection Act.** The TCPA (Telephone Consumer Protection Act) addresses the regulation of unsolicited telemarketing phone calls. Rules include the following:

- ▶ telephone solicitors must identify themselves, on whose behalf they are calling, and how they can be contacted
- ▶ telemarketers must comply with any do-not-call request made during the solicitation call
- ▶ consumers can place their home and wireless phone numbers on a national Do-Not-Call list which prohibits future solicitations from telemarketers.

**CAN-SPAM Act.** The CAN-SPAM Act (Controlling the Assault of Non-Solicited Pornography and Marketing Act of 2003) supplements the Telephone Consumer Protection Act (TCPA). It

- ▶ bans sending unwanted email 'commercial messages' to wireless devices
- ▶ requires express prior authorization
- ▶ requires giving an 'opt out' choice to terminate the sender's messages.

## Anti-trust laws

Brokerage companies, like other businesses, are subject to anti-trust laws designed to prevent monopolies and unfair trade practices.

**Sherman Antitrust Act.** Enacted in 1890, the Sherman Antitrust Act prohibits restraint of interstate and foreign trade by conspiracy, monopolistic practice, and certain forms of business combinations, or mergers. The Sherman Act empowers the federal government to proceed against antitrust violators.

**Clayton Antitrust Act.** The Clayton Antitrust Act of 1914 reinforces and broadens the provisions of the Sherman Act. Among its prohibitions are certain exclusive contracts, predatory price cutting to eliminate competitors, and inter-related boards of directors and stock holdings between same-industry

corporations. The Clayton Act also legalizes certain labor strikes, picketing, and boycotts.

**Anti-competitive behavior.** The effect of antitrust legislation is to prohibit trade practice and trade restraints that unfairly disadvantage open competition. Business practices and behaviors which violate antitrust laws include collusion, price fixing, market allocation, bid rigging, restricting market entry, exclusive dealing, and predatory pricing.

**Collusion.** Collusion is the illegal practice of two or more businesses joining forces or making joint decisions which have the effect of putting another business at a competitive disadvantage. Businesses may not collude to fix prices, allocate markets, create monopolies, or otherwise interfere with free market operations.

**Price fixing.** Price fixing is the practice of two or more brokers agreeing to charge certain commission rates or fees for their services, regardless of market conditions or competitors. In essence, such pricing avoids and disturbs the dynamics of a free, open market.

For instance, the two largest brokerages in a market jointly decide to cut commission rates by 50% in order to draw clients away from competitors. The cut-rate pricing could destroy smaller agencies that lack the staying power of the large companies.

**Market allocation.** Market allocation is the practice of colluding to restrict competitive activity in portions of a market in exchange for a reciprocal restriction from a competitor: "we won't compete against you here if you won't compete against us there."

For example, Broker A agrees to trade only in single family re-sales, provided that Broker B agrees to focus exclusively on apartment rentals and condominium sales. The net effect is an illegally restricted market where collusion and monopoly supplant market forces.

Violations of fair trade and anti-trust laws may be treated as felonies, and penalties can be substantial. Loss of one's license is also at stake. Brokers are well-advised to understand and recognize these laws.

---

## **BUSINESS BROKERAGE**

**Business brokerage vs. real property  
brokerage**  
**Transaction knowledge**  
**Accounting**  
**Determining a price**  
**Business brokerage regulation**

---

Business brokerage is *effecting a sale or exchange of an existing business*. In most cases, the sale of a business entails the simultaneous transfer of an estate in land, whether a leasehold or a fee. Thus to sell businesses, a broker must generally hold a real estate license.

In some states, business brokerage is classified into *opportunity brokerage* and *enterprise brokerage* in accordance with the size of the business being sold.

**Opportunity brokerage** concerns a small business, usually a proprietorship or partnership, where the transaction consists of a sale of assets and an assignment of a lease. **Enterprise brokerage** concerns a larger company, usually a corporation, where the transaction involves the sale of stock and multiple real estate parcels leased or owned by the seller.

The process of business brokerage is similar to real estate brokerage: a broker secures a listing, procures a purchaser, and facilitates the closing. Once a ready, willing, and able buyer is found, the broker earns a commission.

## Business brokerage vs real property brokerage

The critical difference between selling a business and selling real estate is that selling a business includes the transfer of *business income*, *personal property assets*, and, possibly, *liabilities*, in addition to real property. To be competent in this brokerage specialty, a business broker must have specialized skills concerning transactions, accounting, and pricing. A business broker must also rely on a professional team to complete the transaction. Members of this team would include the client's legal counsel, accountant, and, preferably, a professional appraiser.

## Transaction knowledge

**Types of sale.** There are generally two types of business sale transaction for a business broker to be aware of: the *asset sale* and the *stock sale*. In an **asset sale**, the purchaser takes possession of some or all of the assets of the business, as well as the real estate, in exchange for the sale price. The purchase usually does not include acquiring the existing business entity or its liabilities. An asset sale is preferred by buyers who want to buy only portions of a business, or to avoid liabilities inherent in a stock purchase.

In a **stock sale**, a purchaser acquires complete ownership of a business, including the legal corporate entity, all assets, all financial liabilities, and any current or future legal liabilities arising from incidents that have occurred prior to the sale. A purchaser may prefer a stock sale to avoid creating a new business entity or to benefit from a possible tax advantage. In addition, a stock sale keeps a business identity intact, which can be very valuable.

**Transaction documents.** The most common transaction documents in business brokerage are a *sale contract*, an *assignment or real estate sale contract*, a *no-compete agreement*, and a *consulting agreement*.

A **sale contract** sets forth all terms and conditions of the agreement, including exactly what is being sold. An **assignment or real estate sale agreement** is an agreement for transferring any and all real property involved in the transaction. A **no-compete agreement** is a seller's covenant, for compensation, not to compete with the buyer under prescribed conditions and time periods. A **consulting agreement** is an employment agreement that hires the seller to assist the buyer in taking over business operations.

For the most part, transaction documents in business brokerage are not fully standardized. For that reason, a business broker must exercise caution in dealing with document language so as to avoid the unauthorized practice of law.

## Accounting

A broker or agent who wants to undertake business brokerage needs basic proficiency in accounting. In particular, one must know how to read and interpret:

- ▶ income, expenses, and profit on an income statement
- ▶ assets, liabilities, and net worth on a balance sheet

**Income, expenses, and profit.** A business's profit is the revenue remaining from gross income after all expenses have been paid. A business broker must evaluate an owner's income and expenses in order to determine what the business may be worth to a buyer. This often involves interpreting which income and expense items will change after the business is sold. For example, a seller owns a grocery store and uses family members to perform clerical work without pay. If a buyer is a bachelor without children, much of the clerical work will have to be hired out. The additional payroll suddenly changes the store's profitability significantly. Neglecting to consider how income and expenses might change is likely to lead to serious problems in working with buyers.

**Business assets.** The assets of a business include **tangible** assets and **intangible** assets. Tangible assets include:

- ▶ cash and marketable securities
- ▶ inventory
- ▶ trade fixtures and equipment
- ▶ real property
- ▶ accounts receivable

Intangible assets include:

- ▶ the company name
- ▶ trademarks
- ▶ copyrights
- ▶ licenses
- ▶ contracts for future sales of goods or services
- ▶ goodwill

In valuing a business, both tangible and intangible assets must be taken into account, even though intangible assets may be very difficult to appraise.

**Business liabilities.** Business liabilities acquired in a corporate stock sale include short-term debt, such as accounts payable, and long-term liabilities, such as mortgages and leases.

**Goodwill.** Goodwill is a business brokerage term with two meanings. In one sense, goodwill is an intangible asset consisting of any factor that an owner values in the business, apart from any other specific asset. For example, goodwill might include reputation, a long history of success in a market, name recognition, a dominant market share, and an excellent business location.

In the second sense, which is more familiar to accountants, goodwill is the difference in value between an owner's price and the value of all other business assets. For example, if an owner wants \$100,000 for a business, and the totality of tangible and intangible assets is valued at \$80,000, the goodwill is a \$20,000 asset.

**Determining a price** The most difficult task for a business broker is often finding the proper price range for a business. An owner of a smaller business has probably built the business from scratch and tends to overvalue it. Moreover, such an owner may have incomplete and disorganized accounting records, making the valuation of assets quite difficult. Finally, a business's true income may be different for one owner than it would be for another because of variations in management style and ability.

In any case, the value of the business is a function of the following:

- ▶ past, present, and future net profits, and capitalized value of these
- ▶ amount of risk and certainty associated with realizing future profits
- ▶ value of all assets as reflected in the books of account
- ▶ impact of goodwill on the value of the business
- ▶ prices paid for similar businesses
- ▶ all other risks associated with the business

### **Business brokerage regulation**

**Licensing.** A business broker generally must have an active real estate license. In addition, the broker may need to have a valid securities license since a transaction may entail the sale of securities.

**Uniform Commercial Code (UCC).** The Uniform Commercial Code regulates the sale of personal property on a state-by-state basis, and forms the basis for standardized sale documents. Standard documents include promissory notes, security agreements, and bills of sale.

**Bulk Sales Act.** The Bulk Sales Act protects creditors against loss of collateral in an indebted business through the undisclosed sale of the business's inventory. If a business sells over half of its inventory to a buyer, the act declares that the sale is a bulk sale, and, as such, is potentially an asset sale. Since a creditor could lose security in such a sale, the seller must disclose the names of creditors to the buyer in a Bulk Sales Affidavit. The buyer must notify the creditors of the sale, who may then take appropriate action to secure their loans.

---

## **SYNDICATIONS AND SECURITIES BROKERAGE**

### **Syndicating real estate Securities licensing Securities registration**

---

#### **Syndicating real estate**

A real estate syndication is a form of investment in which two or more investors contribute capital to a pool for the purpose of acquiring, managing, and selling an investment property for a profit.

There are two groups of parties in a syndication: the *syndicator* and the *investors*. The syndicator is the organizer and usually the party who provides the expertise to undertake the acquisition, management, and sale of the property. The investors' role is to provide funds. Investors in a syndication have little or no role in managing the investment.

Participants in a syndication may be any legal entity, for example, corporations, partnerships, individuals, and joint ventures. Most often, a syndication is structured as a limited partnership.

**Benefits.** The primary benefit of a syndication is that investors can participate and profit in a venture that would otherwise be beyond their individual financial and managerial capabilities. Financial benefits include income, appreciation, and possible passive loss tax deductions resulting from depreciation.

**Securities licensing** The **Federal Securities Act of 1933** defined participation in a limited partnership as a *security*, since investors expect to make a profit from a common enterprise without direct control over the marketing and managing of the investment.

Since the sale of shares in a syndication represents a sale of securities, syndicators and real estate brokers *must comply with federal and state securities licensing and registration laws*. The primary federal law outlining securities registration and licensing is the **Federal Securities Exchange Act of 1934**. This law requires that any person selling securities must be registered, or licensed, with the Securities and Exchange Commission (SEC). Subsequently, the **Maloney Act of 1938** revised the requirement that securities sellers register with the SEC. Instead, it authorized self-regulation of the securities industry through any national association which would itself register with the SEC. This precipitated the formation of the only such association ever to register with the SEC: the National Association of Securities Dealers, or NASD. NASD later merged with the regulation committee of the New York Stock Exchange to form the Financial Industry Regulatory Agency (FINRA).

At present, all securities dealers must register with FINRA, including real estate brokers wishing to sell syndication participations. Depending on the type of security in question, FINRA issues a variety of licenses authorizing a dealer to market and sell the security.

**The Direct Participation Program license.** In 1980, FINRA (NASD) created a limited securities license exclusively for persons selling real estate syndications and other similar investment programs. The license is called the direct participation program license (DPP license).

There are two levels of DPP license, one for principals of a syndication, the DPP Limited Principal License (the "Series 39" license), and one for salespersons who work for the principal, the DPP Limited Representative License (the "Series 22" license). Both licenses are awarded upon completion of the appropriate examination and FINRA application forms.

## **Securities registration**

**Disclosure and registration.** Real estate syndications are subject to strict disclosure requirements imposed by the Securities and Exchange Commission. Disclosure is in the form of a *prospectus* for the investment program. A

prospectus is a comprehensive summary of all facts relating to the investment. The prospectus also expressly warns investors that there are risks and uncertainties associated with the investment.

Certain syndications must be registered with the SEC. Full-scale registration discloses all aspects of the prospective program.

**Exemptions.** Certain SEC rules allow for exemption from securities registration. Generally, there are two forms of exemption, the *Intrastate Exemption*, and the *Private Offering Exemption*.

▶ **The Intrastate Exemption**

if the syndicator, the property, and all investors are located within a single state, the syndication is exempt from registration

▶ **The Private Offering Exemption**

if the syndication is limited to 35 investors or fewer, and the syndication is not advertised in any way, the program is exempt

Whether the syndication is exempt or not, a syndicator must give investors a prospectus of the syndication.

**State regulation.** All states have securities licensing and registration laws in addition to federal laws. As a rule, these laws recognize FINRA licensing and self-regulation practices. However, real estate licensees wishing to engage in syndications should be familiar with applicable securities laws in their state.

# 13 The Brokerage Business Snapshot Review

## FUNCTION AND ORGANIZATION

### The core activity of brokerage

- procuring buyer, seller, tenant, or leased property for a client, often with the help of other brokers and a multiple listing service
- skills: listing, marketing, facilitating, managing information
- Multiple Listing Service: network of brokers who share listings

### Who may legally broker real estate?

- yes: sole proprietorship, for-profit corp., general or limited partnership, joint venture.
- no: non-profit corp., business trust, cooperative association

### Types of brokerage organization

- independents; franchises; agencies by property type, by transaction type, and by client type; limited and full service agencies

## THE BROKER-SALESPERSON RELATIONSHIP

### Legal relationships

- salesperson is agent, fiduciary of broker; acts in broker's name; subagent of client
- **may not:** have two employers; be paid by other parties; bind clients contractually

### Salesperson's employment status

- may be employee or contractor; relationship defined by agreement

### Obligations and responsibilities

- agent to broker: obtain & sell listings; follow policies and employment provisions; promote ethics and broker's reputation
- broker to agent: provide data, office support, compensation, training; uphold ethics, policies, and employment agreement

### Agent compensation

- commissions per schedule after splits with cooperating brokers

## OPERATING A REAL ESTATE BROKERAGE

### Obtaining listings

- generate prospects; develop price range; complete listing presentation; negotiate execute and agreement

### Marketing listings

- develop marketing plan; sell and qualify prospective buyers; complete necessary disclosures; obtain offers

### Pre-closing activities

- facilitate fulfillment of contract contingencies and provisions
- no commingling or conversion of escrow funds

### Managing information

- property data; buyer and tenant files; market data files

### Policy manual

- written procedures and policies on all aspects of the business to ensure smooth, consistent operations

### Advertisement regulations

- no misleading ads; must contain broker's ID; broker responsible for content; no blind ads

### Anti-trust laws

- Sherman Act and Clayton Act pioneered antitrust laws to prohibit unfair trade practices, trade restraints, and monopolies

- illegal to collude, disadvantage competitors; fix prices; allocate markets
- BUSINESS BROKERAGE**
- sale of existing business and its real estate; opportunity and enterprise brokerage
- Business brokerage vs. real estate brokerage**
- special skills: transaction knowledge; accounting; determining the price
- Transaction knowledge**
- types of sale: asset sale and stock sale
  - documents: sale contract; real estate sale contract or assignment; no-compete agreement; consulting agreement
- Accounting**
- income, expenses, and profit
  - balance sheet: assets, liabilities, net worth
  - assets: tangible and intangible
  - goodwill: intangible asset--difference between price & other assets
- Determining a price**
- reconciliation of income, cost, and market data approaches; influenced by risk and stability of future income
- Business brokerage regulation**
- may need securities license; must comply with Bulk Sales law
- SYNDICATIONS AND SECURITIES BROKERAGE**
- Syndicating real estate**
- pooling capital and expertise to profit from property investment
  - syndication is a security; investor may profit without management
- Securities licensing**
- must be FINRA-licensed to sell DPP's (syndications); Limited Principal License to own; Limited Representative License to sell
- Securities registration**
- must disclose; must register with SEC if not exempt; DPP exempt if within state or offered unadvertised and limited to 35 investors