Journal of Housing Economics 28 (2015) 130–143

Contents lists available at ScienceDirect

Journal of Housing Economics

journal homepage: www.elsevier.com/locate/jhec

How many listings are too many? Agent inventory externalities and the residential housing market

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ARTICLE INFO

Article history:
Received 18 August 2014
Revised 19 February 2015
Accepted 8 April 2015
Available online 13 April 2015

JEL classification:
R30
R10
L85

Keywords:
Residential housing
House prices
House liquidity
Principal–agent problem
Moral hazard
Asymmetric information

ABSTRACT

Given the significant role of real estate agents in the housing market, this study examines how agents' incentives regarding the size of their listing inventories indirectly affect residential home prices and liquidity. The theory shows that taking on additional inventory generates a critical principal–agent issue, resulting in the dilution of an agent's selling effort and, ultimately, creating an externality that adversely impacts housing market outcomes across listings. It remains an empirical question whether diluted sales effort leads to lower prices, longer time on market, or both. The empirical results reveal significant inventory externality effects, as greater agent inventory tends to reduce selling price and substantially reduce liquidity for clients' properties in this market.

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1. Introduction

A popular view in real estate brokerage is that visibly busy agents are productive agents,[1] conflating ubiquitous advertisements or numerous FOR SALE signs creating exposure for a particular agent's listings with performance. But what casual observers define as indicators of productivity may also signal potential drawbacks for clients and the residential housing market. This paper considers whether agents have an incentive to take on too many listings—at least from the point of view of their clients. Additional listings may represent additional broker commissions, but they also place greater claims on the broker's time and energy, which in turn can have adverse sales performance consequences for their clients. This paper focuses on the relationship between agents' inventory of listings and sales performance (in terms of selling price and liquidity) in order to ascertain the degree, if any, to which agent listing inventories adversely affect client sales outcomes.

The compensation structure in the real estate brokerage industry constantly puts agents in situations where they must balance their own interests with various clients' interests. Agents are rewarded only if the property sells, as traditional full service broker compensation does not take into account the effort exerted to sell a particular property (Kurland, 1991). The exclusive ownership of listings means that, the more listings a broker secures, the

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[1] This paper uses broker and agent interchangeably to refer to licensed real estate salespersons.

http://dx.doi.org/10.1016/j.jhe.2015.04.002
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greater the probability of receiving more commission income. The theory offered here focuses on how the incentive to acquire listings drives the relationship between listing inventory and market outcomes. Intuitively, the theory implies that, even if broker effort to obtain new listings does not divert effort from sales activities in general, adding to the inventory nonetheless forces the broker to reallocate marketing effort among all houses in the expanding inventory of listings. After a certain point, greater inventory increases the total amount of sales effort needed to service clients, thereby increasing the marginal cost of selling effort. The resultant higher opportunity cost of agent sales effort reduces sales effort allocated to individual houses, with the resultant negative external effects on realized sales performance. Whether the lower sales performance is reflected in lower selling prices, longer time on the market or both remains an empirical question.

This paper is organized as follows. Section 2 reviews the relevant literature on agency in real estate. Section 3 presents a simple model of agent behavior illustrating how greater agent inventory impacts housing market outcomes in terms of sale price and/or liquidity for individual client properties. Section 4 of the paper describes the sample and the data. Section 5 presents the empirical framework, explaining how a three stage least squares (3SLS) methodology can be applied to examine the sales performance effects of agent inventory within a simultaneous price and liquidity framework. In addition, a new measure is developed to account for varying overlaps of agent inventory and distance between listings in the inventory. Sections 6 and 7 report the empirical results showing that greater listing agent inventory has significant and negative effects on selling prices and liquidity of properties. Section 8 concludes.

2. Principal–agent issues in real estate brokerage

When clients acquire brokerage services for the sale of property, a contract is negotiated between the client and agent. This contract gives the client an implicit expectation that the listing agent's priorities are at least somewhat aligned with his or her own. Clients generally want to sell their properties as quickly as possible and at the highest possible price. Given that the listing agent receives a commission only if a buyer is found (either by the agent or a cooperating broker), it is therefore understandable why the client may expect the agent to market the property to locate potential buyers. Generally, clients may not expect to receive substantially reduced service as a result of the reallocation of agent effort to selling another, more expensive home or one that offers a higher commission. Nonetheless, agents have multiple clients, most with similar expectations of primary focus on his or her individual property who are likely to be disenchanted with the listing agent if their expectations are not met. Depending on individual utility and holding costs, some sellers will choose a pricing strategy of setting list price at or below market value with the anticipation of a quicker transaction, while others may choose an exposure strategy of pricing above market value and waiting for a buyer to be matched (Benjamin and Chinloy, 2000; Genesove and Mayer, 1997).

While it is standard operating procedure for brokers to use comparable properties as a basis for suggesting an initial listing price, they have considerable latitude choosing comparable properties, which presents an opportunity to support a wide range of asking price recommendations. Recognizing that many real estate agents tend to focus on a pricing strategy (Benjamin and Chinloy, 2000) coupled with assumption that agents want to sell their entire inventory, agents have incentives to suggest list prices that promote faster sales (Yavas and Yang, 1995; Knight, 2002; De Wit and van der Klaauw, 2013). The unanswered question is whether the incentive to do so increases with greater inventory. At the least, it is possible that the effects of managing larger listing inventories may have differential effects on selling price and selling time for individual properties.

Sellers may be drawn to list with an experienced broker with a large inventory of listings. Nonetheless, it is possible that these sellers do not fully appreciate the complexity of an agent's various roles and responsibilities beyond listing and selling their home, some of which lead to inherent principal–agent conflicts. Indeed, the real estate and residential housing literature has not yet fully digested the complex interactions of agent's actions in terms of the logistics required to manage the acquisitions of new listings, marketing and negotiating existing listings all the way through closing and the renegotiation of expiring listings (Turnbull and Dombrow, 2007). The agent's overall burden of responsibilities grows with each additional listing. As a result (as shown in the next section) we may expect the proportion of effort that the agent dedicates to a given property decreases as inventory rises.

Research on principal–agent issues in brokerage is increasingly intertwined with the literature concerned with modeling pricing and liquidity in housing markets. Principal–agent issues are relevant for commissions, firm size, vacancies and geographic specialization (Zorn and Larsen, 1986; Knight et al., 1994; Yang and Yavas, 1995; Yavas and Yang, 1995; Knight, 2002; Benefield et al., 2012; Read, 1993; Brastow et al., 2012). Miller (1978), Anglin et al. (2003) and Horowitz (1992) find that a higher list price leads to longer marketing time. Knight's (2002) empirical study of listing price changes concludes that a greater difference between list price and selling price generally leads to a longer time on market and ultimately a lower selling price.

The principal–agent relationship between seller and listing agent arises out of a key information asymmetry, as sellers have difficulties monitoring broker effort. Most sellers of owner-occupied homes are infrequent market participants which likely exacerbates asymmetric information problems. Asymmetric information also provides an opportunity for agents to misrepresent market information (Arnold, 1992; Hort, 2000; Garmaise and Moskowitz, 2004). In addition, pure commission-based compensation induces broker moral hazard in part because it does not efficiently allocate risk between seller and broker

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