



## The Subprime Blame Game: Where Were the Realtors?

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It is a scene millions of Americans have been in -- sitting next to a real estate agent at closing to sign the loan contract and other papers for a new home. Often, the buyer has spent months with the agent. And to hear agents tell it, they are indispensable guides through the hazardous home-buying terrain.

How is it, then, that millions of borrowers took on toxic subprime mortgages that could cost them their homes? Why did their agents not warn them off? While much criticism has been leveled at subprime lenders and mortgage brokers, real estate agents have yet to receive their fair share of the blame for the subprime mess, says Shanna Smith, president of the National Fair Housing Alliance. "I think the greed factor works with agents as well as loan originators," she recently noted.

Others say it's not that simple. "The broker, 99% of the time, is the agent of the seller, so the broker doesn't have any duty to the buyer," said Wharton real estate professor [Georgette Chapman Phillips](#).

Subprime loans, typically offered to borrowers with poor credit, usually start with low "teaser" rates that keep monthly payments smaller than they'd be on fixed-rate loans for the same amount. But after one, two or three years the rates are adjusted annually, often leaving buyers paying more than if they'd taken fixed loans. Many subprime borrowers are now seeing their monthly payments jump by 30% or more.

This fall, Congress, the White House and numerous state and federal regulators are struggling to find remedies to the subprime mess, which some experts think could result in two million home foreclosures. Even the presidential candidates have chimed in. Some approaches would allow federally sponsored firms like Fannie Mae and Freddie Mac to help stressed borrowers refinance. Others target lenders by requiring better loan-risk disclosure to borrowers.

The real estate industry has not been sitting on the sidelines. The National Association of Realtors, which represents 1.3 million agents, this fall called for the Federal Reserve to tighten underwriting standards, which would make it harder for lenders to offer loans to borrowers who could not afford the higher payments that subprime loans often require down the road. The NAR also has supported a Senate bill that would offer subprime borrowers an alternative by expanding availability of fixed-rate loans backed by the Federal Housing Administration.

But there has been little focus on the role of the realtors themselves, even though the agent often serves as the home buyer's chief advisor. Indeed, many realtors help buyers find loans by recommending lenders or mortgage brokers. "A lot of these mortgage companies are captive lenders of the [real estate] brokers," Phillips said.

At the heart of the matter is the way agents are paid -- traditionally through a commission, paid by the seller, of 5% or 6% of the home's sales price. Nudging buyers toward subprime loans, or keeping mum about the risks, means more sales go through. Also, the low teaser rate on a subprime loan allows the buyer to borrow more, helping to boost sales prices and commissions. "You can't lie," Phillips said of the agents. "You cannot intentionally mislead somebody. But you work for the seller."

"It is my experience that real estate agents have been pushing people to buy more expensive homes than they were initially qualified to buy under 30-year, fixed-rate [loan]s," said Smith of the National Fair Housing Alliance.



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She recalled a young Washington, D.C., couple that had pre-qualified for a fixed-rate loan no larger than \$310,000. "Their agent kept pressing them to look at \$400,000-plus properties because he could get the same payment, or even lower payment, for them for a more expensive home," she said. How? By encouraging them to get a "2/28" subprime, 30-year loan that started with a low rate which would reset two years later, and then again in each of the 28 subsequent years. The borrowers qualify for such a loan based on their ability to make the initial, low payments, even if they cannot afford the higher payments likely to come later. By selling the more expensive home, the agent earns a larger commission, she noted.

"Of course, he used the standard line of agents and loan offices: 'You can always refinance in two years,'" she said. "He never told them their payment would jump 30% in month 25, or how hard it may be to refinance.... And in two years, the borrower blames the lender for their fix, not the agent who steered them to a higher priced home and a 2/28 loan."

Many subprime borrowers are now finding they cannot refinance to escape their rising payments. In some cases, their homes have fallen in value so they cannot borrow enough to pay off the older loans. Others cannot qualify for the fixed-rate "prime" loans they need, or they are prohibited from refinancing by prepayment penalties meant to assure the lender that the borrower's high payments would continue for a minimum number of years.

### Running Afoul of the Code

Real estate agents typically spend much more time with home buyers than mortgage brokers and lenders do, and presumably could issue warnings about risky loan products. But experts are divided over the agent's legal and ethical responsibilities. Only a minority of buyers hire a "buyer's agent" whose primary responsibility is to them. In most cases, an agent, even if he or she has been working with the buyer, is still paid by the seller, usually by splitting the commission with the seller's agent.

"You work for whoever pays you," Phillips said, adding: "Should a broker tell a buyer, 'You realize that you're in completely over your head here?' -- when the mortgage company has already said to the buyer, 'Sure, you can have the money.' Why would the broker ever do that?"

"It's pretty complicated," said NAR policy expert Jeff Lischer. "A good agent, in order to get the job done and help the person buy or sell ... is going to do whatever has to be done to [accomplish that]." In his view, an agent working for the seller might be free to suggest that the buyer get professional help with lending issues, but a seller's agent should not give advice on the pros and cons of different types of loans.

The NAR has a consumers' brochure describing the pros and cons of various loans, and another one warning home buyers about predatory lending. But Lischer said he did not know how many agents hand the brochures out. The NAR also has a lengthy code of ethics which calls for agents to "treat all parties honestly" and to "protect and promote the interests of their client," whether the client be buyer or seller. Since it is usually the seller, a realtor could run afoul of the code by warning a buyer off a particular loan and killing a deal. Moreover, the code bars realtors from professing to be experts in areas in which they are not.

David Berenbaum, executive vice president of the National Community Reinvestment Coalition, a non-profit organization that works to improve credit access in poor communities, said he has known some real estate agents to look out for borrowers. But, he added, "we see problems where in fact ....real estate agents, like the mortgage brokers, have been part of the problem, or silent."

The realtors' code of ethics, he said, does require a commitment to fair-housing laws and "transparency," or openness about all aspects of the sale's transaction. That leaves room for the realtor to raise a red flag over a hazardous loan, he said. "If a deal is not sustainable -- meaning, if a consumer cannot afford the transaction -- they should not be proceeding with it," he noted.

Agents, even if working for the seller, do have some ethical duties to buyers, adds [Alan Strudler](#), professor of legal studies and business ethics at Wharton. "It's wrong to exploit the vulnerable, and that's what goes on when you stick somebody with one of these loans.... If the law is behind in recognizing this, then it's time for the law to change."

Legally, the agent's obligations to buyer and seller are generally governed by state laws, and most of those

emphasize the agent's fiduciary responsibility to the seller, said real estate expert Jack M. Guttentag, emeritus finance professor at Wharton.

Under federal law, it is illegal for lenders to pay kickbacks to real estate agents who steer them business, Guttentag said, but he said virtually no effort is put into enforcing this rule. "It's very difficult to prevent one party from delivering something of value to another party, even if it's just a Christmas present," he said. "I'm sure that on a small scale it's violated all the time." When real estate agents recommend specific lenders or mortgage brokers, the chief incentive is to assure that a loan is made so the sale is complete and the agent receives the commission, he said.

"Realtors care about only one thing -- making the sale," added Kenneth Thomas, a lecturer on finance at Wharton, adding that if the buyer needs a subprime loan for the deal to go through, the agent is likely to keep silent about the hazards.

Wharton real estate professor [Todd Sinai](#) argues that even if the seller's agent offered the buyer objective loan advice, the buyer should be wary. "In order for the agent to say this is an appropriate mortgage for you, you would have to reveal a lot of stuff to that agent that you might not want to reveal," he said, noting that a smart buyer would lose negotiating leverage if she let the seller's agent know how much she could afford to spend.

While many critics feel that real estate agents contributed to the subprime mess by aiding and abetting unscrupulous lenders and mortgage brokers, not many argue that the agents are the best target for reform. Thomas believes the Federal Reserve and other banking regulators need more authority over the currently unregulated lenders who were most active in the subprime market. Sinai thinks lenders should be required to more fully disclose subprime-loan risks -- by showing how high monthly payments could go, for example.

Guttentag suggests prohibiting lenders from charging many of the fees that have made subprime loans so profitable. But he warns there will always be loan products that are too risky for some borrowers. It's just not realistic to expect much help from real estate agents who make money only when a sale goes through. "I wouldn't tell a consumer that he can rely on the real estate broker to protect him from an avaricious loan provider," said Guttentag. "That would not be good advice."

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