Hurricane Katrina and Ethical Issues in Real Estate Brokerage: An Analysis of the National Association of REALTORS® Code of Ethics

by

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Introduction

Ethical codes and standards of practice are written in times of calm and rational thought – no one drafts such documents in the midst of a tempest, yet it is in tempestuous times that challenges to ethics are often the greatest. We examine the Code of Ethics and Standards of Practice of the National Association of REALTORS® and how application of the principles stated in that document may have been affected after a catastrophic event such as Hurricane Katrina in a residential real estate market that is peripheral to the GO Zone, the Hattiesburg, Mississippi, MSA. The interested reader may consult, for instance, Roulac and Larsen and Coleman, for studies related to disclosure and ethical issues in real estate.

Let us make clear from the outset that it is not our intention to suggest, nor do we purport to possess any evidence, that ethical violations occurred or have even been reported in the region studied. Given the environment we intend to describe, it is highly probable that opportunities for ethical misconduct arose in the area; absent information to the contrary, however, we must rightfully assume that those ethical problems were avoided or resolved honestly in accordance with the REALTOR® Code of Ethics and Mississippi Real Estate Commission License Law. We cast no aspersions on the character of any individual or group of individuals involved in real estate brokerage in our study area.

The paper is arranged in the following manner. Section Two frames our story. Section Three presents some ethical standards that may have had potential to be violated more easily during our study period than at other times. Section Four presents commentary and a conclusion.

Hurricane Katrina, Residential Real Estate, and the Hattiesburg, Mississippi, MSA

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1, 2 Code of Ethics and Standards of Practice of the National Association of Realtors®, Effective January 1, 2005.
3 We recognize that not all real estate professionals are REALTORS®. However, the REALTOR® Code of Ethics is used throughout our discussion as a national standard of ethical behavior for the industry.
6 Code of Ethics and Standards of Practice of the National Association of Realtors® (2005).
7 Mississippi Real Estate Commission License Law, Revised 2005, available online at www.mrec.state.ms.us.
On August 29, 2005, Hurricane Katrina made landfall near Biloxi, Mississippi, as a category 3 hurricane on the Saffir-Simpson Scale. As has been well-documented, Katrina proved to be the costliest Atlantic hurricane in the history of the United States, causing an estimated $75 billion (USD) in total damages. The world watched as television crews captured photographic evidence of this deadly natural disaster, which not only damaged property but also contributed to at least 1,599 deaths (estimated), making it the deadliest hurricane in over 75 years.\(^7\)

One of the most obvious effects of Hurricane Katrina to those living in the affected areas was the immediate shock to the populations of the affected region. New Orleans, Louisiana, MSA, with an estimated population of 1.3 million people before the disaster, was almost abandoned after the Lake Pontchartrain levees failed and the city flooded. Likewise, the Mississippi Gulf Coast Region (Jackson, Hancock, and Harrison Counties) sustained an incredible amount of damage that was directly related to the tidal surge and hurricane-force winds that assaulted that area. Infrastructure, businesses, and residential areas were destroyed or severely damaged, leaving inhabitants to seek alternative living space in a temporary, semi-permanent, or permanent manner. Hattiesburg, Mississippi, had an estimated 50,000 residents (within the corporate limits) before Hurricane Katrina’s arrival. Less than one month post-Katrina, Hattiesburg’s estimated population had swelled to 70,000, representing a 40% increase in directly related to Katrina. Many of these displaced individuals and families learned very soon that their domiciles had been destroyed and that replacement housing was a necessity.

The anecdotal story of Hurricane Katrina is supported by the basic economic supply and demand graph for a market with fixed supply, Figure 1. Suppose that at Time 1 we see fixed supply \(S_1\) and demand \(D_1\), we see equilibrium price \(P_1\) at quantity \(Q\). If demand rises at Time 2 to \(D_2\), price rises to \(P_2\), though still at quantity \(Q\), given Supply \(S_1\). This is the standard supply and demand figure used in many real-estate related textbook examples.

Salter and King show that Hurricane Katrina had a distinct impact on the residential real estate market in the Hattiesburg area, affecting both the selling prices of properties in the area and the marketing times of those properties, as well as the relationship between physical property characteristics and both price and time.\(^8\) Table 1 presents descriptive statistics for the Hattiesburg MSA’s residential real estate market for a period of 30 days before Katrina and 30 days after Katrina.\(^9\) These statistics illustrate some of the changes in selling prices and marketing times of properties due to Hurricane Katrina. A two-sample t-test for differences of means of Sales Price (pre v. post) and Days on Market (pre v. post) indicates that the means of both Sales Price and Days on Market changed significantly, while a two-sample F-test for differences of variances around the mean indicates that the variances of Sales Price and Days on Market changed

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\(^7\) [www.wikipedia.com](http://www.wikipedia.com)
\(^9\) Source: Hattiesburg Area Association of REALTORS® Multiple Listing Service.
significantly.\textsuperscript{10} Taken together, we are left with the conclusion that the Hattiesburg residential real estate market underwent a significant change caused by Katrina.

In this changing environment, real estate professionals were undoubtedly left to make decisions with imperfect information. It is this uncertain environment that introduces the potential situations to arise that could result in agents, brokers, and other professionals taking actions that could, unknown to them, place them at risk of an ethical violation. In the following section, we review some potentially problematic issues and suggest a plan of action for local, state, regional, and national real estate bodies that could help limit the potential for future ethical issues in these areas.

**Pertinent Ethical Standards**

The *Code of Ethics and Standards of Practice of the National Association of REALTORS®* provides the ethical framework in which REALTORS® operate. The *Code* consists of a Preamble and seventeen Articles with associated Standards of Practice. We have identified five Articles and/or Standards of Practice whose successful execution may have been hindered by Hurricane Katrina, and we suggest possible remedies that we believe should be adopted by appropriate bodies to protect both real estate professionals and consumers.

**NAR Code of Ethics Article 1, Standard of Practice 1-3**

**Code:**

“REALTORS®, in an attempt to secure a listing, shall not deliberately mislead the owner as to market value.”\textsuperscript{11}

**Potential Issue(s):**

Real estate professionals generally provide information regarding the approximate value of a property vis-à-vis documentation from the local Multiple Listing Service (MLS), the proprietary database of properties listed for sale in the area. When such systems are unavailable (as in the case of loss of utility services for extended periods) or when the information in the database may no longer accurately describe current market conditions (see Table 1), the information sources for value estimates may become less reliable, and professional judgment may be the governing source of opinions of value.

**Suggestion(s):**

Real estate professionals should consider a special disclosure for such emergency instances that would underscore the commitment of the real estate professional to provide

\textsuperscript{10} t-statistic for means of Sales Price = -3.24 (p < .01), t-statistic for means of Days on Market = 2.27 (p < .02), F-statistic for variances of Sales Price = .66 (p < .01), F-statistic for variances of Days on Market = 1.31 (p < .025).

\textsuperscript{11} *Code of Ethics and Standards of Practice of the National Association of Realtors®*, Article 1, Standard of Practice 1-3 (2005).
the best possible services and to put forth his or her best efforts in representing the consumer. The statement should, however, also disclose the fact that a full information environment is not available and that market value estimates may be volatile, given the rapidly changing market dynamics. Such a statement, when legally executed, would serve as both a disclosure to the consumer and an indemnification of the professional(s) involved.

**NAR Code of Ethics Article 1, Standard of Practice 1-4**

**Code:**

“REALTORS®, when seeking to become a buyer/tenant representative, shall not mislead buyers or tenants as to the savings or other benefits that might be realized through use of the REALTOR®’s services.”

**Potential Issue(s):**

As the number of potential buyers increases after an occurrence such as Hurricane Katrina, the advertising value of franchise and professional designations undoubtedly has the potential to increase. Whereas local consumers may include personal reputation of the real estate professional in their decision-making processes, newly-located consumers may seek out a professional based on affiliation with a national franchise (e.g., RE/MAX, ERA, etc.) or with a professional who has attained a professional designation (e.g., REALTOR®). Such consumers may have unreasonable expectations regarding REALTOR® services that could eventually lead to unwarranted dissatisfaction on the part of the consumer.

**Suggestion(s):**

The local governing body for real estate should ensure that its disclosure statement regarding Standard of Practice 1-4 is sufficiently clear. Further, real estate professionals should be encouraged to emphasize said statement at time of employment, especially in unusual market conditions.

**NAR Code of Ethics Article 2, Standard of Practice 2-1**

**Code:**

“REALTORS® shall only be obligated to discover and disclose adverse factors reasonably apparent to someone with expertise in those areas required by their real estate licensing authority. Article 2 does not impose upon the REALTOR® the obligation of expertise in other professional or technical disciplines.”

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12 Id., Article 1, Standard of Practice 1-4.
13 Id., Article 2, Standard of Practice 2-1.
Potential Issue(s):

After catastrophic acts of God such as Katrina, adverse factors may be much more difficult to discover, even for real estate professionals with training in pertinent areas.

Suggestion(s):

Emphasis should be placed on existing disclosure related to Standard of Practice 2-1 or disclosure related to said standard should be added to existing disclosure documentation. Real estate sales professionals should refer clients with uncertain situations to licensed inspectors, contractors, builders, or other construction professionals with expertise in diagnosing and correcting problems that may have arisen because of the act of God and that may or may not have been preexisting. To facilitate referrals and protect its membership and consumers, the local real estate organization should compile and maintain a database of reliable, licensed construction professionals and home inspectors. He database should be accessible to real estate professionals in the area.

NAR Code of Ethics Article 11, Standard of Practice 11-1

Code:

When Realtors® prepare opinions of real property value or price, other than in pursuit of a listing or to assist a potential purchaser in formulating a purchase offer, such opinions shall include the following: 1) identification of the subject property, 2) date prepared, 3) defined value or price, 4) limiting conditions, including statements of purpose(s) and intended user(s), 5) any present or contemplated interest, including the possibility of representing the seller/landlord or buyer/tenants, 6) basis for the opinion, including applicable market data, 7) if the opinion is not an appraisal, a statement to that effect.  

Potential Issue(s):

As previously discussed, non-appraisers often provide opinions of value based on market data, generally taken from the local MLS. Such data may become rapidly dated and inappropriate for use in describing market dynamics in the post-catastrophic event environment. Professional judgment may be relied on more heavily in such instances.

Suggestion(s):

Special disclosure of uncertainty of market data during periods following major market-affecting events would serve to mitigate a real estate professional’s liability in such circumstances.

14 Id., Article 11, Standard of Practice 11-1.
NAR Code of Ethics Article 12, General

Code:

“REALTORS® shall be careful at all times to present a true picture in their advertising and representations to the public. REALTORS® shall also ensure that their professional status (e.g., broker, appraiser, property manager, etc.) or status as REALTORS® is clearly identifiable in any such advertising.”\(^{15}\)

Potential Issue(s):

As discussed earlier, consumers unfamiliar with a given market area will most probably rely on national branding as a decision variable in the choice of a real estate professional. In a chaotic business environment, the potential for misrepresentation, including misrepresentation by confidence men, scam artists, or grifters, increases.

Suggestion(s):

It is incumbent upon the individual(s) holding REALTOR® status to self-regulate and ensure that only REALTORS® display such brands. The local Association of Realtors should, if it has not already done so, establish a plan to deal with such abuses, including a publicized telephone number to allow the public to report abuses and a cooperative plan to work with the local authorities and the local Chamber of Commerce and/or the Better Business Bureau.

Commentary and Conclusion

The preponderance of real estate professionals behave in an ethical manner, else consumer trust would not exist for the profession. Chaotic and unusual market circumstances, however, may present even the most ethical of individuals with unfamiliar situations. The purpose of national, state, and local real estate boards and associations is to promote the profession and to protect real estate professionals and consumers. As such, situations that arise after remarkable events, such as those that may have arisen in the study area after 2005’s Hurricane Katrina, are opportunities to refine ethical and legal codes.

In a normative framework, we present five selections from the *Code of Ethics and Standards of Practice of the National Association of REALTORS®* and illustrate potential issues that may have arisen under a rapidly changing market and under uncertain circumstances. We also suggest minor disclosure changes that could be easily implemented by governing bodies prior to catastrophic events; these suggestions could serve to further protect consumers and real estate professionals under such adverse and foreign circumstances. Even in states where *caveat emptor* is the rule of law, some studies have shown that disclosing more is a dominant strategy to disclosing less.\(^{16}\) We

\(^{15}\) *Id.*, Article 12.

agree that, while the profession has a highly ethical reputation, safeguards could be
crucial to maintenance of that reputation.
Figure 1.
Short-Run Supply and Demand Graph for a Local Residential Real Estate Market
Table 1.
Descriptive Statistics for Sales Price and Days on Market

<table>
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<tr>
<th>Variable</th>
<th>Pre-Katrina (N = 304)</th>
<th></th>
<th></th>
<th></th>
<th></th>
<th>Post-Katrina (N = 183)</th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Mean</td>
<td>Median</td>
<td>Std. Dev.</td>
<td>Minimum</td>
<td>Maximum</td>
<td>Mean</td>
<td>Median</td>
<td>Std. Dev.</td>
<td>Minimum</td>
<td>Maximum</td>
</tr>
<tr>
<td>Sales Price</td>
<td>$147,197.80</td>
<td>$122,500.00</td>
<td>$92,779.91</td>
<td>$12,500.00</td>
<td>$549,000.00</td>
<td>$179,539.10</td>
<td>$148,000.00</td>
<td>$114,359.20</td>
<td>$10,000.00</td>
<td>$650,000.00</td>
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<tr>
<td>Days on Market</td>
<td>114.1711</td>
<td>77.5</td>
<td>124.3247</td>
<td>2</td>
<td>950</td>
<td>89.77596</td>
<td>49</td>
<td>108.7351</td>
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