AMERICAN BANKERS ASSOCIATION

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November 28, 2005

Lee Quinn
Antitrust Division
U.S. Department of Justice
Liberty Place, Suite 300
325 7th Street NW
Washington, DC 20530

Office of the Secretary
Federal Trade Commission
Room 135-H (Annex F)
600 Pennsylvania Avenue NW
Washington, DC 20580

Re: Competition and Real Estate Workshop
Comment, Project No. V050015

Dear Sir or Madam:

The American Bankers Association ("ABA") is pleased to offer the following comments to assist the Department of Justice ("Justice") and the Federal Trade Commission ("FTC") in their examination of competition in the real estate brokerage industry. The ABA, on behalf of the more than two million men and women who work in the nation's banks, brings together all categories of banking institutions to best represent the interests of this rapidly changing industry. Its membership—which includes community, regional and money-center banks and holding companies, as well as savings associations, trust companies and savings banks—makes ABA the largest banking trade association in the country.

ABA strongly believes a competitive market is the best way to provide quality real estate brokerage and management services. Increased competition in a market economy benefits consumers by encouraging innovation, increasing efficiency, and lowering prices. However, by any standard, the real estate brokerage market is considerably less competitive than it should be and commissions are artificially high, as demonstrated in our attached white paper, *Lack of Competition in Real Estate Commissions.*

From the Department of Justice's first antitrust suit regarding fixed commission rates in the late 1940s to today, the dominance in the real estate brokerage market by members of the National Association of Realtors ("NAR"), through manipulation of the Multiple Listing Service ("MLS") and other means of limiting competition, has warranted close oversight. There have been dozens of lawsuits to stop blatant antitrust violations by NAR members ("Realtors"), the most recent of which the Justice Department filed in September 2005. In its 1983 staff report, *The Residential Real Estate Brokerage Industry,* the FTC concluded that price-fixing was a founding principle of the earliest real estate associations, which have since evolved into the National Association of Realtors.

Real estate commission rates in the United States have been remarkably constant over time as house prices have rapidly increased, despite market innovations (such as Internet listings) that should work to reduce significantly the costs of buying a home. In fact, the six percent commission fee that most buyers and sellers expect to pay has barely declined during the last three decades. With house prices doubling in many areas, home sellers end up paying real estate brokers twice the amount in commissions for the same amount of service.

Improved Technology Should Reduce Costs

The Internet has driven housing search and property information costs down considerably, but little of those reduced costs seem to be passed on to homebuyers and sellers. This technology has enabled potential homebuyers to do for themselves much of the research that has traditionally been done by real estate brokers. For example, in addition to price and location, increasing numbers of buyers are able gather for themselves key pieces of information about potential properties, such as flood history, contract status, room dimensions, schools and community facilities, real estate taxes and other costs, and so forth.

NAR's own surveys find that buyers researching properties on the Internet spend over twice as much time gathering information as those who do no Internet research before contacting an agent.[1] Importantly, NAR's survey found that these same buyers also moved much more quickly once they began to work with an agent, spending much less time with the agent and previewing far fewer homes than buyers who did not get advance information from the Internet. According to the survey, buyers who used the Internet spent an average of two weeks with their real estate agent and looked at approximately seven homes before making their choice. Buyers that did not do Internet research spent approximately six weeks with their agents and looked at approximately 15 homes before making their choice.

With individuals assuming more of the responsibility for gathering and assessing information, real estate agents have to spend less time and effort to assess market conditions (for sellers) and identify and show houses to prospective buyers. The cost of brokerage services, therefore, should decrease reflecting this shift in burden,

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[1] *NAR Buyer and Seller Survey Confirms Recent Trends*, accessible at www.realtor.org/PublicAffairsWeb.nsf/Pages/02BuyerSeller?OpenDocument.

as has happened with so many other financial services. Unfortunately, this is not case for real estate brokerage services.

Real estate agents aggressively guard their commission rates through the use of the Multiple Listing Service (MLS) and other means. The MLS is a restricted database that lists 70 percent to 80 percent of the available homes for sale in the United States and generally excludes homes for-sale-by-owner. The MLS provides detailed information on homes for sale that are listed by NAR members, including the commission rates and "split" or "cooperative" commissions offered by seller agents to potential buyer agents. NAR effectively prohibits the use of the MLS by nonmembers.

Market Concentration Harms Consumers, Independent Brokers

The real estate industry is increasingly concentrated. In fact, the top three firms[2] in the brokerage business control 56 percent of the market. By comparison, the top 50 banks have 56 percent of the banking market. Cendant Corporation, for example, accounts for one out of every three real estate agents and alone has a 34 percent market share of existing home sales. And because consolidation within the real estate industry is occurring at breakneck speed, small realty companies are far more likely to be bought up by one of the major real estate firms.

As the industry has consolidated under the Realtor umbrella, the percentage of Realtors representing both sides of a transaction has increased. This may result in some commission reductions given greater control of the overall deal, but it means that commissions are also controlled more.

Independent and discount brokers have helped somewhat to lower the average commission rate, but they represent a mere one percent of the market share. Moreover, evidence suggests they face considerable pressure to conform to Realtor standards.

Realtors and real estate commissions are attempting to abolish discount brokers by mandating a specific set of minimum services that a real estate agent must provide. For example, in January 2005, the Texas Real Estate Commission proposed a state rule that would force licensed real estate brokers to provide a minimum level of services – whether or not these services are requested by customers – including:

- Accepting and presenting offers and counteroffers to buy, sell or lease property on behalf of their clients;
- Assisting clients in developing, communicating, and presenting offers, counteroffers and related notices; and
- Answering their clients' questions relating to offers, counteroffers and notices.

On April 20, 2005, the FTC and Justice wrote a joint letter to the Texas Real Estate Commission stating that the proposed change to real estate rules in Texas would

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[2] Cendant, RE/MAX, and Prudential Real Estate.

completely eliminate some limited-service brokerage options and is "likely to harm consumers by reducing competition" between limited-service brokers and full-service brokers."

Since Texas first proposed the minimum-service language, other states have considered their own licensing law changes relating to limited-service brokerages, including Illinois, Missouri, and Wisconsin.

Increased Competition More Important Than Ever

With housing prices at an all-time high, brokerage commissions cost sellers (and ultimately homebuyers) tens of thousands of dollars with each real estate transaction, making increased competition more critical than ever. The benefits of competition are well known. In a free market, businesses choose to offer new products if they believe they can provide better services at competitive prices. Increasing the number of providers able to compete freely on the basis of price and service raises the bar for all the participants, forcing improvements in efficiency, pricing and service levels—all to the benefit of homebuyers and sellers.

More players allowed to compete freely in the real estate brokerage and management business mean more and better products for consumers. In any competitive market, new participants bring new, creative ideas to the market—all designed to provide better service and greater convenience, at reasonable prices. In fact, businesses can only be successful in new markets by providing services that meet the needs of customers. Free competition among a wide variety of providers is the cornerstone of our economic system and always leads to customer benefits.

Although NAR repeatedly states that there are no barriers to entry into the real estate brokerage market, the organization itself has moved aggressively to block banking organizations from offering real estate brokerage and management services. NAR takes this position despite the fact that real estate companies are heavily involved in the mortgage lending business.

The reality is that in today's real estate market, it is commonplace for real estate companies, securities firms and insurance companies to provide end-to-end services, including brokerage, mortgages, and insurance. ABA believes offering this combination of services is good for many consumers. Yet, not all financial institutions have equal ability to offer these comprehensive options. The Gramm-Leach-Bliley Act, adopted in 1999, was designed, among other things, to address these inequalities and broaden competition among financial services.

Pursuant to that law, in January 2003 the Federal Reserve Board and the Treasury Department issued a proposed rule to designate real estate brokerage and property management services as activities that are "financial in nature" for financial holding companies and financial subsidiaries of national banks. Since that time, the National Association of Realtors has, through the Congressional appropriations process, successfully blocked the Treasury Department from expending any funds to finalize the proposal.

On November 8, 2005, the American Antitrust Institute conducted a symposium in Washington, DC, at which 90 experts and stakeholders discussed the lack of competition in residential real estate brokerage industry. Expert research presented at the symposium found evidence of collusion, anti-competitive behavior, and efforts at the federal and state level to restrict market access. The AAI concluded "there is little evidence of significant price competition[.]"

Also, new research by Robert Hahn, Robert Litan, and Jesse Gurman recommended that banks be allowed to offer real estate brokerage services in order to enhance competition.[3]

The bottom line is that many Realtors are doing everything in their power to deny home buyers and sellers easy access to information they have grown accustomed to especially since home listings went online ten years ago. Their efforts are designed to limit competition based on price and service, including the ability of discount brokers to compete, frustrating the for-sale-by-owner process, and blocking entry into the market by other players. Their goal is to maintain artificially high commission rates at the expense of home buyers and sellers everywhere.

The need for reform is abundantly evident, and customers stand to reap large gains from such timely change.

Sincerely,

Attachment

[3] *Bringing More Competition To Real Estate Brokerage,* AEI-Brooking Joint Center for Regulatory Studies, November 2005.

Lack of Competition in Real Estate Commissions

A Staff White Paper by

The American Bankers Association

Spring 2005

AMERICAN
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Lack of Competition in Real Estate Commissions

> "Few industries stand to gain as much information, convenience, and efficiency from technology as the buying and selling of homes. Yet this industry has been slow to adopt Internet and eCommerce technologies and business models, and has erected barriers to prevent innovation and competition – even from within industry ranks."
>
> — Steve DelBianco and Michael Tavilla in *The State of eCommerce 2002: Beyond the Bubble, Beware the Barriers.*

Lack of competition in real estate commissions has resulted in windfall profits for the real estate brokerage industry at the expense of homeowners who pay commissions that are based on rapidly increasing housing prices, instead of on the level of service they receive. In 2004 alone, even without considering significant savings from greater efficiency, consumers paid excess commissions conservatively estimated at more than $16 billion.

If the market were competitive, commissions could fall as much as by half. In fact, in countries with strong market economies and highly developed information systems, residential real estate commissions of 1 percent and 2 percent are the norm – not the standard 6 percent commission characteristic of most U.S. markets. At these commission rates, average savings could be as much as $10,000 per sale[1].

Today, an exclusive group of real estate brokers, under the umbrella of the National Association of Realtors (NAR), hold the keys to most homes for sale in the United States. "Realtors," a term which is trademarked, are real estate brokers who pay dues to NAR. Their market dominance grants them a luxury most Americans don't have: they don't have to negotiate on price and, generally, they don't.

The 6 percent commission fee that most buyers and sellers expect to pay has barely declined during the last three decades, despite market innovations that should work to significantly reduce the costs of buying a home, such as Internet listings. With house prices doubling in many areas, Realtors are earning double commissions. Home sellers can end up paying twice the amount of commission for exactly the same service.

Take Washington, D.C., for example. In 2002, the median sales price of existing homes was $250,000; in 2004 it was $351,000 – a 40 percent increase – and, with commissions a fixed percent of the sales price – this meant a ***40 percent increase in real estate commissions***. Were properties harder to sell in 2004 than they were just two years earlier? In both 2002 and 2004, homes sold at 98.3 percent of the asking price in the same average number of days (35 days). It's hard to argue extra effort was required. In hot markets, houses practically sell themselves.

The same story is repeated in market after market. In the face of rapidly rising sales prices, real estate commissions rarely seem to vary. The average commission rate may fluctuate somewhat, but excess commissions are still the norm and it's the buyers and sellers that pay the price.

Market innovations, particularly Internet listings, reduce the cost of home transactions by increasing efficiency. But the savings are not passed on to consumers due to the anti-competitive efforts of

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[1] Based on current U.S. average home price of $260,000, this figure represents the difference between commissions of 2 percent and 6 percent.

Realtors, who control the way most information is shared about available homes. This is accomplished, in part, through use of the Multiple Listing Service (MLS), which NAR controls.

MLS contains detailed information about 70 percent to 80 percent of the available homes for sale in the United States with most of the remainder being "for-sale-by-owner." Not only is access limited to those who work with Realtors, ***significant information contained in the database is never shared with consumers***. This practically guarantees Realtors an unfair advantage over non-Realtors and encourages imitative price-setting at the going rate. Because any sale requires both the seller's agent and buyer's agent – both of whom are usually Realtors – to cooperate, MLS enables Realtors to foster a "guild" mentality that can be used to isolate and punish any agent who competes on price.

NAR's business strategy is pure and simple: to limit competition and to keep commissions artificially high for dues-paying Realtors. This paper quantifies the financial loss that buyers and sellers suffer as a result of these anti-competitive practices, and exposes the types of practices that have led to excess commissions. This paper further shows how homeowners and homebuyers alike would benefit by increased competition.

I. Are Real Estate Brokerage Commissions Competitive?

To understand why real estate commissions are too high, it is useful to consider how competitive markets usually work. Normally, the price at which goods or services are sold fully reflects the supply (marginal cost) and the demand for the goods and services. If either the supply or the demand changes, prices should adjust. Real estate brokerage services, theoretically, should follow the same model, however, a near constant commission for decades is evidence that a competitive market does not exist – to the detriment of home sellers and buyers.

Commissions Should Be Independent of Asset Price

Like all transactions, there are several key costs related to the buying and selling of real estate:[2]

(1) Search costs – the cost home buyers and sellers pay to find one another;
(2) Information costs – the cost home buyers pay to research the market and pricing trends; and the cost to sellers pay to appraise and sell their homes at market prices;
(3) Bargaining and decision costs – the cost of negotiating and assessing the terms of sale relative to other offers;[3] and
(4) Policing and enforcement costs – the costs of ensuring that the transaction met the terms of the sale and that unmet terms were remedied.

[2] These four elements stem from the seminal work of Ronald Coase in 1937 on the theory of transaction costs and the nature of the firm. The idea – for which Coase was awarded the Nobel Prize in Economics – is simple. All transactions require information. Information is costly to acquire, and thus imposes a "transaction cost" on the economy that reduces economic efficiency and societal well-being. Together, these costs determine how much firms will rely on third parties to produce the goods and services they sell, how big firms will get, and how buyers and sellers finally consummate a deal.

[3] Typically, both the agents on either side of the transaction technically work for the seller. Thus, the buyer may therefore reveal damaging information to the agent. Disclosure helps to reduce the probability that damaging information might be revealed, but as professors Gene Marsh and Leonard Zumpano note in their paper *Agency Theory and the Changing Role of the Real Estate Broker: Conflicts and Possible Solutions*: "Allowing brokers to act as agents for buyers would provide protection and guidance for buyers as well as resolve the conflict of interest currently facing brokers by encouraging specialization within the industry." (Journal of Real Estate Research, Vol. 3, No. 2, 1988.)

Note that the price of the house being bought or sold, or asset value, is not a factor in how much it costs to conduct a real estate transaction. Verification of title, credit checks, and other administrative and processing services are the same regardless of the asset value. Even if a 6 percent fixed commission reflected the true marginal cost of real estate services at one house price, it certainly does not follow that this same 6 percent would be the correct commission for house prices above or below that level.

In fact, theory would predict that as the asset values rise, the commission percentage should fall. For example, the marginal cost of selling of a $300,000 home is not likely to be twice the cost of selling a $150,000 home. Is the work necessary to sell a $1 million house equal to that required to sell ten $100,000 houses? Moreover, we would expect to see variations in brokerage commissions across geographical regions as the supply and demand varies dramatically across the United States, but little if any variations exist. Rates should differ based on the set of services demanded by buyers and sellers, not simply be tied to housing prices.

Sales prices are the critical factor in determining how much time and effort is required to sell a home. If the price is too high, it takes longer to sell the property (either at the offering price, or more likely at a significant discount from the listing price). If set too low, the property sells quickly, as is seen in "hot" markets where competing bids within days of a listing drive the price well above the initial list price. If home sales prices are set correctly, the length of time on the market should stay constant. This simple illustration shows the critical role real estate agents play in helping the seller determine the initial listing price.

Interestingly, research by University of Chicago professors Levitt and Syverson found that "[h]omeowners are induced by their agents to sell too quickly and at a price that is too low." Moreover, the professors state: "…agents sell their own homes for 3.7 percent (roughly $7,700) more than they sell client's homes, and leave their houses on the market roughly 10 days (10 percent) longer. The greater informational advantage the agent enjoys, the larger the difference between the price and time on the market experience of agents and the clients they represent."[4]

Technology Should Lower Costs <u>and</u> Commissions

If any of the true costs of buying and selling a home – search costs, information costs, bargaining costs, and enforcement costs – go down, commissions should go down, too. In fact, a reduction in any of the costs explained above should lower commissions ***across the board*** in a competitive market.

Technology has reduced costs. The Internet has driven housing search and property information costs down considerably. More individuals are researching available properties for sale. Buyers can themselves gather key bits of information about property location, flood history, contract status, room dimensions, etc. Sellers are better able to determine comparable prices for similar houses, helping them to gauge the appropriateness of a listing price suggested by an agent. With individuals assuming more of the responsibility to gather and assess information, less time and effort is required by real estate agents in assessing market conditions (for sellers) and in identifying and showing houses. The cost of an agent's service, therefore, should go down reflecting this shift in burden.

[4] Levitt, Steven D. and Syverson, Chad. Market Distortions when Agents are Better Informed: The Value of Information in Real Estate Transactions, University of Chicago, December 2004.

A NAR survey found that Internet buyers spend more than twice as much time gathering information prior to contacting an agent compared to non-Internet users. At the same time, they moved much more quickly once they began to work with an agent, spending much less time with their agent and previewing far fewer homes compared to pre-Internet buyers. Moreover, buyers who used the Internet spent on average two weeks with their real estate agent and looked at approximately seven homes. Pre-Internet buyers spent approximately six weeks with their agents and looked at approximately 15 homes before purchasing.

In January 2004, the California Association of Realtors conducted its 5th Annual "Internet Versus Traditional Buyers Survey" exploring the home-buying process. For the first time in the history of this survey, more than half of the respondents were classified as Internet buyers, defined as those who used the Internet as a significant part of the home buying process. Internet buyers as a percentage of all buyers rose from 45 percent in 2003 to 56 percent in 2004, while the percentage identified as traditional buyers fell from 55 percent to 44 percent. This trend is expected to continue.

II. What Should Rates Be?

Real estate commission rates in the United States have been remarkably constant over time as house prices have rapidly increased. "Discount brokers" have helped somewhat to lower the average commission rate, but they face considerable pressure to conform and only comprise a small (1 percent) market share. As the industry has consolidated under the Realtor umbrella, the percentage of Realtors representing both sides of a transaction has increased. This may result in some commission reductions given greater control of the overall deal, but it means that sale prices are controlled more, too.

What consequences does this have for consumers? There are two components of excess commissions: (1) the amount reaped from increased housing prices in excess of inflation, and (2) the excess that results from an inefficient marketplace that unfairly advantages Realtors.

Regarding excess commissions relative to inflation, consider the facts: The average home price has increased from $115,083 in 1990 to $233,925 in 2004. Some of this increase ($51,000) is a reflection of general inflation (in goods and services, including housing) and some ($67,000) reflects real changes in the demand (and supply) of housing. Having a fixed commission rate means that Realtors take advantage of changes in demand – increasing their returns by as much as 40 percent – even though the price they charge has nothing to do with the actual cost of providing brokerage services.

What should commission rates be? Consider that commission rates averaged 6.1 in 1990, which would have generated an ***inflation-adjusted*** commission of $10,146.[5] If the standard of living were the same today as in 1990, the commission rate necessary to generate the same real return – keeping the real estate agent just as well off – ***is 4.34 percent***. But even if we accept the untested assertion that current rates are averaging 5.1 percent today, this means that home sellers are paying excess commissions of $1,784 dollars (more than a 15 percent premium). In 2004 alone, the ***excess profits*** to Realtors was $16 billion.[6]

[5] The actual, non-inflation adjusted commission, was $6,904.

[6] These estimates assume that 70 percent of sales are completed using a real estate agent. The NAR found that the percentage of houses sold without a Realtor dropped to only 14 percent in 2004, which implies an even greater excess commission for the industry. We use a very conservative approach in the estimates above.

Excess commissions are even more dramatic in hot real estate markets. Between 2002 and 2004, ***real*** home prices increased (after the CPI adjustment) by an average of 41.0 percent ($95,982) in the top 15 markets, ranging from 30.4 percent ($107,193) in Honolulu to 59.3 percent ($99,207) in Las Vegas.[7] With fixed commissions, real commissions grew by the same percent! ***Competitive markets would have led to an average commission in these markets of 3.62 percent in 2004 – an excess commission that should have gone to the buyers and sellers of $4,880 per transaction.***

Table 1
Data For Top 15 Hottest Housing Markets

Metro Area	Median Existing Home Price (In 2004 Dollars) 2002	2004	% Change	CPI (02-04) % Change	Commission Rate with Open Competition[1]	Excess Commission Per Transaction
Las Vegas, NV*	$167,193	$266,400	59.3%	4.6%	3.24%	$4,960
Riverside/San Bernardino, CA	$188,199	$296,400	57.5%	6.6%	3.20%	$5,629
Reno, NV*	$191,675	$284,300	48.3%	4.6%	3.44%	$4,724
Sacramento, Ca	$219,925	$317,600	44.4%	4.6%	3.59%	$4,797
Los Angeles Area, CA	$309,223	$446,400	44.4%	6.6%	3.53%	$7,002
Orange County, CA	$440,056	$627,300	42.6%	6.6%	3.53%	$9,831
Sarasota, FL	$185,893	$264,100	42.1%	5.5%	3.61%	$3,934
San Diego, CA	$390,495	$551,600	41.3%	7.2%	3.58%	$8,397
Bradenton, FL	$158,251	$220,100	39.1%	5.5%	3.67%	$3,154
Miami/Hialeah, FL	$200,991	$277,200	37.9%	5.9%	3.70%	$3,887
Melbourne/Titusville/ FL**	$117,409	$158,600	35.1%	4.2%	3.83%	$2,019
Ft. Lauderdale/Hollywood, FL	$208,615	$278,000	33.3%	5.9%	3.78%	$3,682
Washington, DC/MD/VA	$264,421	$351,100	32.8%	5.7%	3.84%	$4,421
Daytona Beach, FL**	$112,825	$148,600	31.7%	4.2%	3.87%	$1,828
Honolulu, HI	$352,807	$460,000	30.4%	5.3%	3.91%	$5,474
Average For Top 15 Markets	***$233,865***	***$329,847***	***41.0%***	***5.5%***	***3.62%***	***$4,880***
National Average (all Markets)	***$196,875***	***$233,925***	***16.6%***	***5.0%***	***4.34%***	***$1,778***

[1] Open competition commission rate calculated by dividing Average 2002 Home Commission by Average Home Price.
* CPI figure estimate based on urban southern U.S. city with population between 50,000-1,500,000.
** CPI figure estimate based on urban western U.S. city with population between 50,000-1,500,000

[7] An illustration is helpful to understand the calculation: For Riverside, had house prices risen with the level of inflation only, the median house price would have been $188,149 (the remaining $108,201 was due to increased demand for housing beyond inflation). Had commissions provided the same real return to Realtors, the commission would have been $9,596 (i.e., 5.1 national 2004 average commission rate on $188,149). This would have created a 3.24 percent commission rate on house valued at $296,400 (i.e., the median nominal house price). Thus, the excess commission is $5,629 (i.e., the difference between $9,596 and $15,116 (5.1% rate on $296,400).

Simply put, just holding Realtor profits constant would have driven commissions down by another 15 percent. Moreover, as the next section demonstrates, efficiency gains from advances in technology should drive commission rates to 3 percent or below – at least 40 percent less than average rates today. Simply put, if real estate markets were competitive, commissions would be far lower, saving buyers and sellers billions of dollars.

U.S. Commissions are High by International Standards

To see how technology and efficiency can drive commissions down, one can look to other countries where there are fewer barriers to a competitive real estate market than exist in the United States. Professors Natalya Delcoure (Mitchell College) and Norm Miller (University of Cincinnati) studied home sales in 31 countries and found that sales commissions are abnormally high in the United States.

Out of the 31 countries studied, only four – Russia, Belarus, China and Mexico – had commission rates higher than those in the United States (see Table 2). Not surprisingly, the study found that commission rates are lower when the "information within the market is more efficient, open, and reliable."[8] Conversely, rates are higher in countries where information is often costly and unreliable in less developed countries – something not characteristic of developed countries with competitive markets.

The authors state: "It appears that commission rates in the U.S. are abnormally high for a country as efficient as we presumed and as price competitive as we would like it to be."[9] Moreover, "It is hard to argue that non-U.S. countries have more efficient communication technology, real estate public information or record access that would lead to lower commission rates."[10]

Table 2
List of Countries by Commission Fees

Country	**Real Estate Commission Fee (mode)**
Hong Kong	1%
Netherlands, Singapore, United Kingdom	2%
Belgium, Denmark, Italy, Japan, Malaysia, Norway	3%
Greece, Ireland, Israel, Thailand	4%
Germany	4.5%
Australia, Brazil, Canada, Caribbean, Finland, Indonesia, Philippines, Spain, Sweden	5%
Argentina, **United States**	6%
China, Mexico	7.5%
Belarus, Russia	10%

[8] Natalya Delcoure and Norm G. Miller, International Residential Real Estate Brokerage Fees and Implications for the U.S. Brokerage Industry, International Real Estate Review, 2002, Vol. 5, No. 1: page 24.
[9] Ibid., page 28
[10] Ibid., page 14

What commission rates are suggested by this international evidence? "Based on the estimated coefficients, US residential brokerage fees should equal something closer to 3 percent versus the common 6 percent or 7 percent fee." This would mean a ***savings to consumers of $4,912 per transaction in 2004 alone.***

Moreover, the authors conclude that fees in England and Hong Kong – at 2 percent and 1 percent respectively – are "close to equilibrium, while fees in the U.S. seem to be artificially high based on price rigidity within the U.S. system."[11]

They state: "If the typical U.S. agent were as productive as those in England, the brokerage fees would be closer to 1.5 percent."[12] This would mean a savings to consumers of $8,421 per home in 2004. Of course, in the hottest markets the savings would be much greater (see Table 4).[13]

Not only are real estate commission rates lower in other developed countries, but the authors found evidence in the United States that U.S. real estate commissions are not competitive. For example, the authors found that "[i]n some countries, commission rates vary with the difficulty of the sale or the price level of the home."[14] Moreover, there was no fixed commission as a percentage of the assets value.

In fact, "[h]igher priced homes see lower commission rates in these regions, indicating that the cost structure and profitability of buying/selling homes in not linear with respect to price. This behavior is consistent with price competitive markets, and we should expect the same to occur within any market that is not characterized by price rigidity."

The lack of price competition in residential real estate is also evident in the low sales per agent in the United States. The logic is simple: in competitive markets, if commissions were excessive, new realtors would enter driving the commission rates down. With fixed commission rates, the excess profits still encourage new realtors to enter, but the result is that sales per agent fall. Thus, not only does the home buyer/seller pay much higher commission rates but the average realtor does not benefit as the excesses are spread more thinly throughout the industry. Two academics studying the issue, Chang-Tai Hsieh and Enrico Moretti, called this phenomena in real estate "social waste."[15] The study by professors Delcoure and Miller found only two countries (out of 20 reporting data) – Belarus and Israel – have lower sales per agent per year than agents in the United States.[16]

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[11] Ibid., page 29

[12] Ibid., page 13

[13] "Explanations for relatively higher fees for U.S. firms included greater liability, and the provision of more services, whether they are desired by consumers or not. But the interdependency of the traditional industry that has tended to reduce price competition and encourage imitative pricing seems to be the most compelling explanation." Ibid., page 28

[14] Sweden, Finland, Ireland, Mexico, and Belarus.

[15] Chang-Tai Hsieh and Enrico Moretti, "Can Free Entry be Inefficient? Fixed Commissions and Social Waste in the Real Estate Industry" National Bureau of Economic Research.

[16] In competitive markets, the real estate commissions would decrease in hot markets where sales were occurring quickly and home values were rising. With fixed high commissions, excess profits initially would occur, but would attract more Realtors seeking a portion of the excess. This would spread out the returns to individual agents, decreasing efficiency, potentially reducing quality as inexperienced Realtors enter – all with absolutely no benefit to the consumer. On the other hand, in weaker markets, the real estate commissions would typically rise, reflecting the great degree of difficulty selling any property. However, with fixed commissions, the weaker market drives out the marginal Realtors, thereby improving the return to the remaining, presumably more capable, agents.

"Fundamentally, it really hasn't changed since the Twenties, says Michael Davin of California discounter CataList. The average Realtor today sells fewer than six houses a year. While other fields have become more productive, Davin says, "real estate has gone backwards."[17]

Other Evidence Shows Residential Real Estate Commissions Uncompetitive

Two additional examples – commercial real estate commissions and stock brokerage commissions – help to demonstrate how uncompetitive residential real estate markets are today.

Regarding commercial real estate market, Professor Susan Wachter of the University of Pennsylvania Wharton School Real Estate Center, notes: "...there is considerable rate diversity in commercial real estate brokerage" [18] that does not exist in the residential market. Wachter attributes this to several factors, including greater information available to the broker and the clients in these markets, the greater frequency that buyers and sellers may enter into transactions (which places a premium on maintaining a good reputation and discouraging agents from overcharging for services rendered); and the lack of the exclusive "right-to-sell contract" which is ubiquitous in the residential markets. Wachter notes: "With an open listing contract, a lower cost broker with a buying customer does not need the cooperation of a full rate broker to contact a selling client."[19]

Reductions in brokerage fees in other financial services industries also suggest the real estate commissions are artificially high. Evidence in the stock brokerage industry supports this estimate. In 1990, stock commissions were 6.3 cents per share; in 2004, they were 4.5 cents per share – a 28 percent decline. If real estate commissions would have followed suit, the commission today would be 4.39 percent – nearly identical to the inflation adjusted commission rate calculated above.

III. Market Constrained by Realtors

A powerful strategy by which Realtors aggressively guard their commission rates is through the use of the Multiple Listing Service (MLS). This is a restricted database that lists 70 percent to 80 percent of the available homes for sale in the United States and generally excludes homes for-sale-by-owner. ***It is controlled by NAR, which prohibits its use by non-Realtors.*** MLS database provides detailed information on homes for sale that are listed by Realtors, ***including the commission rates and "split" or "cooperative" commissions offered by seller agents to potential buyer agents***.

Most MLS contracts explicitly have a non-compete clause prohibiting use, "directly or indirectly, in any other MLS or information system utilized by unlicensed consumers or licensed real estate person, whether accessible through the Internet or otherwise."[20]

Control of information by Realtors – through MLS – is the key to controlling commissions, as Stanford professor Bruce Owen explains: "[I]t appears that the mechanism for price-fixing activities among brokers is the coordination provided by local MLS organizations. Because the information

[17] Carnahan, Ira. "Will Zip Get Zapped? Traditional real estate brokers are going after the Internet discounters." Forbes, August 16, 2004.
[18] Susan M. Wachter, *Residential Real Estate Brokerage: Rate Uniformity and Moral Hazard*, Research in Law and Economics, 1987, page 200.
[19] Ibid., page 201.
[20] North Texas Real Estate Information Systems, Inc. MLS Contract.

provided by MLS is very useful to buyers and sellers, and is generally unavailable elsewhere, brokers outside MLS organization rarely can compete with members."[21]

Even some Realtors are troubled by the practices of their industry. For example, Doug Palin, of REMAX Equity Group in Vancouver, Washington wrote in a March 3, 2005 letter to the editor of Inman News:

> *I have read with interest the different debates about MLS data over the years and I believe that if a homeowner who was trying to sell his or her home knew how we were protecting all the listings, he or she would be incensed over it.*
>
> *The bottom line is homeowners just want to sell and we have told them we will do whatever is necessary to expose their home to the market. Anyone who is doing anything short of that is not doing right by the homeowner, in my opinion.... We are one day going to see a real estate industry that is unlike anything that has come before it, and a major part of it will be some national site or sites that have all the available listings and somehow stays current. That's what the consumer wants and that is what he or she is going to get eventually.*

Realtor Practices Encourage Price-Fixing: MLS in Action

For commission rates to be nearly identical for decades requires several conditions: (1) an implicit or explicit agreement on prices; (2) an ability to detect under cutting; and (3) a way to discourage undercutting.[22] Control of information by Realtors – through the Multiple Listing Services – is the key to anticompetitive behavior.

The first condition is easily satisfied. In the case of Realtors, agents must belong to the local, regional and national Realtor associations to participate in the multiple listing services, thus creating a "guild" that tends to support and protect the will of the majority. Moreover, an overwhelming majority of homes are sold through MLS members, with the remainder being "for sale by owner." Thus, professor Owen notes, it is not "surprising that so many brokers belong to MLS organizations. Without access to MLS system, most brokers could not stay in business, for the information provided is the brokers' most valuable asset. Thus, brokers have strong incentives to do whatever is necessary to maintain their membership in an MLS organization."[23]

Agreement on a fixed price is facilitated by the fact that commissions are based on sales prices. Thus, while most price-setting in other industries would have to have complex methods to signal agreement with the price, in real estate brokerage "by setting fees as a percentage of selling value, there is only one

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[21] Owen, Bruce, *Kickbacks, Specialization, Price Fixing, and Efficiency in Residential Real Estate Market,* Stanford Law Review, Vol. 29, page 931, May 1977.

[22] Barring entry of new firms would also typically be needed to achieve monopolistic profits. In residential real estate, however, the excess commissions – which the consumer pays for – is spread among all agents. This is one reason why the sales per agent is so low. See Wachter, Op cit., pages 189-210. The Realtors have argued that the large number of agents, the small size of real estate firms and the modest average income suggest collusion is difficult. Anglin and Arnott conclude that: "None of these points is persuasive. While there are many agents nationally, most brokerage markets are highly localized so the number of agents in a particular market is modest." Their analysis also shows that "the size of firms is irrelevant" and that "the modest average income is consistent with collusion pricing and underemployment."

[23] Owen, Op cit., page 931.

number for all firms to agree upon."[24] This simple one-price formula also creates the impression on the part of the seller that the rate is non-negotiable.[25]

Second, detection on undercutting is also easy. Professor Wachter notes: "Detecting and penalizing firms for undercutting the agreed upon rate are similarly easy to accomplish in residential real estate brokerage. Discount firms can be detected by their open advertising. In addition, the current practice is for brokerage firms to publish in the MLS book commission rates offered to cooperating brokers (along with the seller's offer price). If a lower commission rate has been negotiated prior to the sale, that too is published."[26]

Professor Owen reaches the same conclusion: "The MLS structure has a built-in device for detecting secret price cutting. Each MLS member always knows what other members are charging because commissions are split between the listing and selling brokers."

"[T]here are a variety of factors indicating that brokers are not in perfect competition with each other and that the widespread rate uniformity at 6 percent is most likely the result of price fixing. For example, brokers are not perfectly homogeneous, and less talented brokers normally would charge lower rates. The fact that rates are uniform indicates that some form of price fixing is in operation. Also, it is not equally difficult to sell all homes and the fact that all sellers must pay the same rate again indicates that some form of price fixing is in operation."
—**Professor Bruce Owen,**
Stanford University (*Kickbacks, Specialization, Price Fixing, and Efficiency in Residential Real Estate Market*, Stanford Law Review, Vol. 29, page 931, May 1977.

Third, discouraging consistent commission rates is also easy in residential real estate brokerage. Cooperation is critical among Realtors.[27] Half of the residential sales involve two firms or different agents, each representing one party to the transaction.[28] Because their commissions are shared, what one side receives depends on the actions of the other side. If the listing agent reduces the commissions, it affects not only his or her own profits, but it also reduces the amount that can be shared with the buyer's agent.

"When cooperative sales represent a significant portion of the firm's business, such price-cutting behavior is not economically feasible. To the extent that firms depend on one another to share the total demand for their services, imitative pricing will be the rule of survival in local markets."[29]

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[24] Wachter, Op cit, page 194. Wachter points out that: "setting a uniform price is considerably simpler to fulfill in residential brokerage than in most industries and would not require continuing explicit acts of collusion that violate antitrust laws."
[25] Barring entry of new firms would also contribute to achieving monopolistic profits. In residential real estate, however, the excess commissions – which the consumer pays for – is spread among all agents. This is one reason why the sales per agent is so low. See Wachter, Susan M., *Residential Real Estate Brokerage: Rate Uniformity and Moral Hazard*, Research in Law and Economics, vol. 10, pages 189-210. The Realtors have argued that the large number of agents, the small size of real estate firms and the modest average income suggest collusion is difficult. Anglin and Arnott conclude that: "None of these points is persuasive. While there are many agents nationally, most brokerage markets are highly localized so the number of agents in a particular market is modest." Their analysis also shows that "the size of firms is irrelevant" and that "the modest average income is consistent with collusion pricing and underemployment."
[26] Wachter, Op cit., page 194
[27] It is also unusual that both the Realtors on either side of the transaction technically represent only the seller. This provides fertile ground of collusion.
[28] Natalya Delcoure and Norm G. Miller, International Residential Real Estate Brokerage Fees and Implications for the U.S. Brokerage Industry, International Real Estate Review, 2002, Vol. 5, No. 1: page 18.
[29] Ibid.

Punishing those who vary from the fixed price is relatively easy, notes Professor Owen: "MLS organizations have a number of methods of enforcing adherence to uniform prices among their members. The most blatant method is to threaten members who depart from fixed prices with expulsion."[30]

The Federal Trade Commission (1983) examined discount real estate brokers, and found that they can be seriously hurt when other agents withdraw cooperation. A discount broker can be refused access to MLS, her integrity can be impugned, and other agents can steer their clients away from her."[31]

Such harm has not disappeared even two decades since the FTC's study. In fact, "commission coaches" encourage this behavior. For example, Jim Gillespie of Temecula, California told MONEY that "he advises agents to use the specter of boycotts to dissuade sellers from listing with discounters."[32]

The influences may be subtle, but they can be very effective. For example, MLS members simply may be less anxious to sell homes listed by brokers who charge less than the fixed rate." This blackballing of listing where Realtors will not show properties listed by discount brokerage agents steers buyers away from properties that may have been ideal for them and lowers the number of competitive bids the seller might have.

"Some traditional brokers also indicated that they believed the interdependence among brokerage firms, especially as it is carried on through the facility of MLS, makes price rather than service competition a futile strategy," the FTC study reported.[33] "This, as we have indicated is because when a listing broker cuts the commission rate he or she usually asks cooperating brokers to absorb part of the price cut, and this moves the alternate listings to the bottom of the list of properties to be shown to a potential customer. Even if a discounter offers the standard split, of course, some brokers may still prefer to cooperate with others who charge the standard rate, because all brokers compete for future listings."

Anti-competitive behavior is also evident from unfair sharing of commissions with the buyer's agent (so-called "adverse splits"), in which listing agents will initiate disadvantaged commission splits with discount agents, which they can do legally. "With simple written notice and no justification, any Realtor can deny payment of commissions to an eCommerce-enabled Realtor," according to *The State of eCommerce 2002: Beyond the Bubble, Beware the Barriers.* [34]

Finally, Realtors use exclusive-right-to-sell contracts for residential real estate, meaning that if the property is sold within the stated period of time, that listing agent receives a commission and sets the

[30] Owen, op cit. In Grillo v. Board of Realtors, 91 N.J. Super. 202, 219 A.2d 635 (1966), the plaintiff sued an MLS organization for a threat of this sort. The plaintiff was awarded $9,000 in damages, but the defendants, brokers of MLS, were found to have earned about $3 million over a 6½ year period. A request for punitive damages was denied. Id. At 232, 219 A.2d at 652. For examples of decisions requiring that MLS access be made available on reasonable, nondiscriminatory terms to all persons licensed to sell real estate, see United States v. Multiple Listing Serv., [1972] Trade Cas. ¶ 74,221 (D. Ore., Dec. 5, 1972); United States v. Long Island Bd. Of Realtors, Inc., [1972] Trade Cas. ¶ 74,068 (E.D.N.Y., Aug. 1, 1972). For discussions of the Grillo case, see Note, Arbitrary Exclusion from Multiple Listing: Common Law and Statutory Remedies, 52 Cornell L.Q. 570 (1967); Note, Restraint of Trade – Private Associations – Exclusive Multiple Listing Service as a Concerted Refusal to Deal and a Tortious Interference with Nonmember Broker's Right to Practice His Profession, 21 Rutgers L. Rev. 547 (1967).
[31] Anglin, Paul M. and Arnott, Richard, "Residential Real Estate Brokerage as a Principal-Agent Problem," Journal of Real Estate Finance and Economics, 4: 99-125 (1991).
[32] *The 4 ½ % Solution,* Money Magazine, October 1, 2004.
[33] "The Residential Real Estate Brokerage Industry," FTC, a Staff Report, December 1983, pg 38.
[34] The NetChoice Coalition, October 2002

cooperative commission for other parties, such as the agent bringing the buyer. Wachter states: "Although cooperative exclusive-right-to-sell and MLS agreements have a rationale in residential markets, it is the use of such agreements that enables brokers to enforce fixed rates by threatening to limit access to MLS buyers and sells only to brokers who abide by them. With an open sales contract, a buyer's offer can be placed directly with the seller, thus, excluding the full rate gatekeeper's tendency to ignore a cut-rate broker's offer. Since the open sale listing broker does not set a cooperating brokerage rate, refusal by selling brokers to show the property, because the fee is too low, also cannot occur."[35]

NAR Works to Limit Competition at State Level

In addition to more subtle influences preventing cuts to commissions, NAR is front and center in its attempts to protect its corner on the real estate market, particularly at the state level:

- As recently as March 2005, the Oklahoma Senate passed a bill to define duties and responsibilities that real estate brokers must perform thereby prohibiting some customized real estate services, such as MLS-only property listings. The proposed bill "is just an injustice to the real estate industry," Steven Sizemore, owner of The Real Estate Place, a real estate company in Oklahoma, told the Inman News, an independent real estate news service. "It restricts competition and restricts free trade in the industry. It primarily protects real estate commissions as opposed to consumers."

- In January 2005, the Texas real estate commission voted to propose a minimum-service state rule that would force brokers to accept and present offers and counteroffers to buy, sell or lease property on behalf of their clients; assist clients in developing, communicating, and presenting offers, counteroffers and related notices; and answer their clients' questions relating to offers, counteroffers and notices. Other states have also pursued similar service standards for real estate brokers, including Illinois, Missouri, and Wisconsin.

- In November, a federal judge in Sacramento ruled in favor of web publisher ForSaleByOwner.com challenging California Realtors' demand that websites obtain a real estate broker's license to publish real estate advertising and information. The court concluded that the law, which requires websites to obtain a license but specifically exempts newspapers that publish the same information, was "wholly arbitrary" and violated the First Amendment guarantees of free speech and freedom of the press.

- In January 2005, Realtors sued the New Hampshire state banking commissioner to stop a mortgage lender from posting homes for sale by owner without a real estate brokerage license. East-West Mortgage, the owner of ISoldMyHouse.com, is a wholly owned subsidiary of Commerce Bank & Trust Co., a state-chartered bank based in Massachusetts, giving the commissioner of banks jurisdiction.

- In October 2004, an antitrust complaint was filed with the FTC in Washington State alleging that a large multiple listing service, Northwest MLS, is attempting to control real estate listings in the state and has worked to drive out other MLSs.

[35] Wachter, Op cit.pg 202.

- State laws provide much-needed protection for consumers, but they also make it illegal – in thirteen states – to pass savings along to buyers in the form of commission rebates. In states where buyer rebates are legal, however, web-enabled Realtors have to battle discriminatory practices of traditional Realtors.

- NAR's proposed virtual office Web (VOW) site policy, which dictated how brokers could share real estate listings with one another for online use. VOWs allow individual real estate brokers to display all for-sale home listings and the complete information about those listings in an online format on the Web. NAR has been attempting to put together a VOW policy since May 2003, and has postponed implementation as a result of a Department of Justice investigation.

IV. Conclusion

The bottom line is that many Realtors are doing everything in their power to deny homebuyers and sellers easy access to information, with MLS system being a prime example. Realtors' anti-competitive tactics, both nationally and on the state level, are designed to limit the ability of discount brokers to compete, and frustrate the for-sale-by-owner process. Their goal is to maintain artificially high commissions at the expense of home buyers and sellers everywhere.

Realtors and the flat commission rates they charge are insulated from normal market forces because their commissions are not based on how much it really costs to buy and sell homes. Instead, they have fixed their profits to asset size. And, with homes representing American's largest source of equity – and growing – Realtors are making larger and larger profits without performing any additional work.

U.S. residential brokerage fees should equal something closer to 3 percent, based on current market analysis. This would mean a ***savings to consumers of $4,912 per transaction in 2004 alone.*** Foreign real estate markets, which cannot be considered more technologically sophisticated than our own, underscore this. Rates paid in the United States are significantly higher than those paid in most developed countries.

The Potential for Abuse.....The Need for More Competition

"In retaliation for discounting, firms can be penalized by excluding them from the information network. Such exclusion may take the form of non-cooperation on the listing and selling sides of the market:

The discount firm that lists houses may find that its properties are disparaged and not readily shown by full rate firms. The full rate firm may claim "difficulty" in getting in touch with or arranging to view the discount broker's listings. If a lower than customary commission rate is listed in MLS book, potential cooperating brokers legally and reasonably may refuse to sell a property for a commission rate that is too low to offer them sufficient compensation. The prohibition of rebates, by many states, prevents brokers from discounting their services, while still listing and providing a full rate for cooperating selling brokers.

The discount firm that shows available houses may find that it has difficulty in arranging to show a full rate firm's listed house to a buying customer. Full rate brokers may procrastinate in returning phone calls from discount brokers or in informing their listing customers of a potential buyer who is represented by a discount broker.

The joint refusal to show properties listed at discount rates and to inform sellers and buyers represented by discount brokers serves a gate-keeping function which limits cut-rate firms' access to buyers and sellers. Even without explicit boycotts of rate-cutters, their potential clients may be discouraged by other brokers' implicit threats of non-cooperation. Passive non-cooperation and disparagement may take subtle forms that either are difficult to police or are perfectly legal. For example, it is not illegal or even unethical for a firm to report that a discount competitor provides fewer or lower quality services. Apart from maintaining any collusive price structure, it is in the interest of full rate firms to make such comparisons simply as a means of attracting clients.

In spite of their subtlety, disparaging comments and implicit threats of non-cooperation may discourage home buyers and sellers from seeking out a discount broker. In this major lifetime financial transaction, potential discount brokers' clients may fear that they will not get full consideration in seeing full rate brokers' house listings or in having their homes seen by full rate brokers' clients. The very threat of this is likely to deter risk-averse buying and selling clients from using a broker who undercuts the customary rate."

— **Professor Wachter**, Wharton School Real Estate Center