

Real estate: Why are you paying 6%?

The real estate industry strives to keep the commission rates high. Here's how.

October 26, 2005: 5:08 PM EDT

By Les Christie, CNN/Money staff writer

WASHINGTON (CNN/Money) - You save by buying prescriptions and contacts via the Internet. You can now trade stocks for just \$10. You purchase airline tickets, rent cars, and book hotel rooms with no transaction fees on the Web.

Yet sell your house and you still pay a 6 percent commission -- a whopping \$12,000 or so on an average U.S. house.

Why hasn't the Internet age ushered in lower real-estate costs?

In other countries, commission rates are about 1.5 percentage points lower, according to the American Homeowners Grassroots Alliance. In the United Kingdom, says University of California professor of economics Chang-Tai Hsieh, commissions average just 2 percent.

Brokers, the National Association of Realtors, and many critics came together in Washington on Tuesday to discuss industry competition and address why the 6 percent commission has proved so durable.

The Federal Trade Commission and the Department of Justice antitrust division, which have spearheaded an assault on NAR practices that they consider against consumers' interests, organized the conference.

Big tent

The NAR maintains that the industry is plenty competitive. NAR economist Lawrence Yun points out there are more than 2.5 million licensed real estate agents in the United States. A quarter of a million new ones signed up last year.

The multiple listing service (MLS), a database of properties for sale in any one area, is available to any licensed agent and member of NAR. A new agent, Yun argues, can open up next to a huge established brokerage and, with hard work, compete.

Furthermore, reports Yun, recent data compiled by Real Trend, an industry information provider, showed that commissions have in fact dropped, to an average of 5.1 percent.

Critics counter that the industry has systematically fought off innovative business models that would introduce efficiencies and save consumers billions of dollars.

One problem, said Hsieh, is that as home prices climb, more agents enter the industry in almost lock-step. That means more and more agents fighting over business -- and a growing need to keep commissions high.

In fact, despite record prices nationally, the average broker actually closed fewer transactions and earned less -- \$49,000 versus \$52,000 -- last year than the year before.

As a result, says Susan Creighton, the director of the Bureau of Competition for the FTC, traditional brokers try to maintain an advantage over Internet-based brokers, fee-for-service providers, and discount brokers that threaten to undermine high commission rates.

Here's some of the methods, according to the FTC:

- **Don't show discounter's properties.** Traditional brokers "boycott" discount-brokers' listings. They refuse to show discount brokers' properties and even refuse to show their own listings to buyers brought in by discounters. This clearly violates the ethics of their profession and the fiduciary duty they have to the sellers, but discounters report that it happens all the time.

Aaron Farmer, founder of Texas Discount Realty, a fee-for-service and discount broker in Texas, says traditional agents harass him, tell clients that he is out of business, even berate his agents in public.

- **Seek legislative actions to restrain trade.** One panelist, Steve DelBianco, of executive director of NetChoice Coalition, pointed out traditional brokers are not reluctant to seek legislative relief to protect their interests.

Brokers have persuaded about 15 state legislatures to enact so-called minimal-service requirement laws. These rules prohibit unbundling of services; that targets fee-for-service brokerages.

If sellers only need minimum service, such as a listing on the MLS, they can pay a small flat fee of about \$500 and get it. In minimum-service requirement states, they have to hire full-service brokers and pay five-figure commissions.

At the conference, hardly anyone supported minimum-service laws. Various panelists described it as anti-consumer. Century 21 CEO Thomas Kunz says his company is against them. The FTC and DoJ has sent letters to various states advising them that the laws are anti-consumer. Even the NAR holds no position.

- **Make it difficult for discounters to get on the MLS.** The MLS is essential to remain competitive as a real-estate broker. It's a database of properties for sale in an area. Brokers with listings put the properties on the MLS so agents with buyers can see them and connect buyer with seller. The brokers split commissions.

Bottom line

The real problem, which Hsieh calls "The Tragedy of the Commissions," is that all these machinations don't ultimately serve the broker, much less the public.

He suggests that the NAR abandon its attempts to prop up commissions. "Price protection," he says, "ultimately does not benefit the price protectors. The efforts are self defeating."

Hsieh says brokers spend more time prospecting for clients -- handing out business cards, cold calling, knocking on doors -- than they spend selling and marketing homes. That's just waste, of no actual value to their clients.

He doesn't necessarily have a solution. But, he says, "We should try to think of ways to create structure to channel competition that will translate into better efficiency and better prices -- not waste."