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The Realtor Racket

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Why are Governors and state legislatures enacting regulations to make buying and selling homes as expensive as possible?

We ask this question because in recent weeks three normally level-headed Republican Governors -- Matt Blunt of Missouri, Rick Perry of Texas and Bob Riley of Alabama -- have signed into law legislation that protects Realtors from discount competitors.

About a dozen other states have also buckled to the National Association of Realtors lobby. They've effectively become partners in what looks suspiciously like a price-fixing scheme, whereby discounters are prevented by law from charging fees below the industry norm of 5% to 6% of the home sales price. The financial victims of this cartel are middle-income home buyers and sellers who are required to pay brokerage fees that can easily be several thousand dollars above a competitive market price.

Real estate brokers are under increasing price pressure from Web-based home-buying services and other discount brokers. With state lawmakers so often bellyaching about the decline in "affordable housing," one would expect politicians to salute these low-fee entrants to the market.

Instead, state legislatures and real estate commissions -- which happen to be populated by Realtors -- are enacting laws that make price competition illegal and thus treat Realtors as if they are members of a closed shop union.

The Realtors argue with a straight face that their political efforts are somehow in the interests of the home-buying public. Maybe we're missing something here, but in almost every other consumer industry -- booksellers, retailers, home appliances, insurance, banking, stock brokers -- the introduction of Internet and discount sellers has been a phenomenal financial benefit to customers. Discount airlines have cut airfares by 60% or more, to the economic benefit of everyone with the exception of the incumbent competitors.

Economists call this process of squeezing out transaction costs "disintermediation." If any industry is ripe for this, it is the \$70 billion-a-year real estate brokerage market. Yes, fees have fallen modestly to about 5.1% on average in recent years. But a new study by the Brookings Institution and American Enterprise Institute concludes that in an unimpeded free market, fees should be dropping much faster -- particularly amid a real estate boom that has doubled home values over the past decade. Many, if not most, of the services that Realtors provide don't vary with the sales price, so the percentage fee should fall as home price rises.

The problem is that state lawmakers are squashing such competition through two types of laws. First, they make it illegal for brokers to provide rebates on their commissions, which is an overt impediment to price competition. So, for example, LendingTree.com is prevented under these laws in about 10 states from continuing its popular practice of providing several thousand dollars of rebates and coupons at Home Depot to homeowners who use its real estate services. Discount real estate agents would also be prohibited under many of these laws from advertising their lower prices in newspapers.

The second legal device used to restrain trade are "minimum service requirements," which prevent real estate brokers from providing limited services to home sellers for a negotiated fee. These rules outlaw the increasingly popular choice of home sellers who contract with an agent to list their homes for a flat fee of typically around \$500, but then handle all the other aspects of the home sale themselves in order to save \$5,000 to \$10,000 in additional fees.

More than a dozen states (see nearby list) have enacted these requirements, which are analogous to telling McDonald's that it can sell french fries only if the customer also buys a hamburger and Coke. We'll also note the supreme irony that states and the federal government sued Microsoft for illegally "bundling" its software, whereas in the real estate market the states are requiring bundling. In either software or real estate, the choice should be up to the individual sellers.

In some states, real estate agents collude to boycott homes that are being sold by agents who provide commission discounts. This practice is a clear breach of the fiduciary duty of the agent to find the best home at the lowest price for clients. Instead, the brokers are in effect finding homes for their clients that will afford them the highest fee structure. To our knowledge, neither the National Association of Realtors nor the state real estate commissions have ever sanctioned a real estate agent for this breach of ethics.

How large is the restraint of trade rents in this industry? One back-of-the-envelope way to quantify the costs to consumers is to compare the 5.1% standard fee in the U.S. to the industry average in other countries, which is estimated at about 3.6%. This means Americans are paying about \$20 billion a year more for real estate services -- or about \$3,000 on an average priced home -- than are home buyers in other nations.

In its own internal documents, the Realtors association acknowledges that the purpose of its state lobbying is to keep competition out and fees high. In an April 22 memo to its state affiliates, the national office urged members to keep agitating for "state laws that are designed to replace competition with regulation." The memo added that "Realtors have the right to lobby for legislative and regulatory action -- even if the effect of such action would be anti-competitive."

In response to a recent U.S. Justice Department complaint against a Kentucky Real Estate Commission policy that prohibited brokerage rebates and "other inducements to attract customers," the Realtors also acknowledged that these laws are intended to keep prices as high as possible.

The brokers admitted that the policy "inhibits free trade" but defended the regulation by arguing that it was necessary to "avoid a bidding war" and to protect against a "lessening of profits." And this was their defense. The Kentucky Real Estate Commission reversed itself, though the brokers no doubt will now scurry off to the state legislature to get a new law enacted.

The Realtors have the First Amendment right to lobby for such anti-consumer legislation. But let's please dispense with their pretense that these laws are intended to "assure that the market for the sale of real estate functions efficiently and in the interests of buyers and sellers."

We have nothing against real estate agents or their trade. In fact, we think the Justice Department is wrong in its recent antitrust complaint demanding that the National Association of Realtors allow online sellers access to its Multiple Listing Service. The listing service is a privately owned data base, not a public utility, and the Realtors should have the right to share it with whomever they wish.

However, with their lobbying for state-imposed restraints of trade, the Realtors are the ones doing financial damage to millions of home buyers and sellers. We don't know who is more at fault here: the Realtors who maintain that such protectionism benefits consumers, or the pliant state lawmakers who actually believe them.