



Consumer Federation of America

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RESIDENTIAL REAL ESTATE BROKERAGE SERVICES: A COCKAMAMIE SYSTEM THAT RESTRICTS COMPETITION AND CONSUMER CHOICE

Testimony of

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Housing and Community Opportunity Subcommittee

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Chairman Ney, Ranking Member Waters, and members of the Subcommittee: My name is Stephen Brobeck. I am Executive Director of the Consumer Federation of America. We appreciate the opportunity to share our views on residential real estate brokerage services with the committee. These views also represent those of the American Homeowners Grassroots Alliance.

For more than a decade, CFA and the AHGA have sought to advance the interest of home sellers and buyers by promoting greater real competition among providers of residential real estate brokerage services. Ensuring this competition has become increasingly important because of the growing importance of homeownership and related services.

Over the past five years, more than 30 million houses and condos have been sold, a large majority with the assistance of real estate brokers and salespersons. Last year, consumers spent

more than \$60 billion on these brokerage services. Yet, consumers poorly understand these complex and confusing services. As a recent article in the *Harvard Journal of Legislation* explains, just the concept of “agency” is extraordinarily complicated with different states adopting different approaches.¹ It is not realistic to expect first-time home buyers, or even first-time home sellers, to adequately understand these services. And when consumers sell and buy different properties at the same time, they are usually preoccupied with the timing of these sales, not the price or quality of the brokerage services they are receiving.

Competition and Consumer Choice Restricted

Prices: Despite the importance and poor consumer understanding of these brokerage services, they are not transparent and competitive like those of almost all other consumer service areas. Take the price of these brokerage services. None of the dominant firms in the industry advertises commission rates or ancillary fees. Nor are these prices listed on their websites or in their advertising. In fact, as CFA has learned, it is a challenge for comparison shopping home sellers to even learn what these prices are. There is no other important consumer service in America where it is so difficult to learn about costs.

Why are these prices not advertised or even made easily available to consumers? The simple fact is that, for decades, the dominant real estate firms and their trade association have tried, with much success, to maintain high, uniform prices within different geographic areas. Any real estate broker or salesperson can tell you what the target commission rate is in their area. Depending on average home prices, this rate is usually 6% or 7%, though in high-priced markets

¹ See Olazábal, Ann Morales, “Redefining Realtor Relationships and Responsibilities: The Failure of State Regulatory Responses,” *Harvard Journal on Legislation*, Vol. 40, 2003.

such as Southern California it apparently has slipped to 5%. And, despite the rise of home prices over the past decade, where a 6% commission rate now represents a charge of \$30,000 on the sale of a \$500,000 house, the dominant firms appear to get this rate on the sale of most homes.

The one recent survey of these rates, which concluded that the average rate was 5.1%, has been persuasively shown to be too low.² Regardless, even at only 5%, the \$15,000 in commission charged on the sale of a \$300,000 home represents a higher price than that charged for many new cars or even sophisticated medical procedures.

How are the dominant firms able to maintain high and fairly uniform prices? There are two key factors. The first is a tacit agreement not to advertise or even easily make available price information. The second is “discrimination” against most service providers that offer and advertise lower prices.

This discrimination is facilitated by a pricing system where home sellers ostensibly pay the entire commission, but listing brokers “split” commissions with any separate brokers working with home buyers. This commission split, which is poorly disclosed to sellers and not disclosed to buyers, is made accessible to brokers on various listing services. In a 6% rate area it is typically 3%, and in a 7% rate area, it is typically 3.5%. A listing broker lists a split below this level at their, and their clients’, peril because of the risk that traditional brokers working with buyers will avoid this property: These brokers not only want the highest possible commission split but also do not want to support brokers offering lower rates. That is why many low-price listing brokers complain that their properties are not shown, and it is why many rebating buyer brokers complain that listing brokers make it difficult for them to show or sell

² Weicher, John C. Director, Center for Housing and Financial Markets, Hudson Institute, “The Price of Residential Real Estate Brokerage Services: A Review of the Evidence, Such as It Is,” November 8, 2005.

properties.

This informal discrimination against price competitors is the most important factor that allows dominant brokers to maintain high and uniform prices. But in eleven states the problem is made much worse by anti-rebate statutes supported by traditional brokers. These blatantly anti-competitive laws, which have been opposed by the Department of Justice, make it impossible for buyer brokers to introduce price competition through rebating a portion of near-uniform commission splits.

In a rational pricing system, home sellers and buyers would each pay for real estate brokerage services they receive. In this system, there would be no hidden commission splits that propped up rates. In the interim, brokers should be required to clearly disclose these splits to sellers and buyers. That disclosure, as it became understood by consumers, would encourage listing brokers to list lower commission splits and buyer brokers to show properties with these lower splits. The result would be more transparent, varied, and lower average commission rates.

Services: An analogous situation exists in regard to services. The dominant brokers not only claim to offer “full service” but have argued that only brokers offering full services should be permitted to do business. That is why, in many states, they have persuaded state legislatures to pass minimum service laws – challenged by the Department of Justice – that restrict service competition, for example, by requiring all service providers to maintain physical offices or accompany prospective buyers on home visits. The goal of these dominant brokers is to restrict competitors who transact business over the Internet or who offer limited services for a lower price.

The fact is that many of these dominant brokers offer less than “full service.” Listing

brokers may not aggressively advertise properties or organize open houses. Buyer brokers may try to restrict searches to in-house listings. There is no uniformity of service among so-called “full service brokers.”

But more importantly, why should there not be a range of service options, particularly in light of the opportunities made possible by the Internet to consumers who wish to list or search for properties, and to those who wish to transact business over the Internet? Until relatively recently, one of the most important broker functions was to identify properties that buyers might wish to consider. Because a large majority of home buyers now start their search on the Internet, where they increasingly are finding the house they end up purchasing, this broker function is diminishing greatly in importance.

Accordingly, it is in the interest of both buyers and sellers for there to be complete information on Internet listings and for this information to be easily accessible. Dominant brokers and their trade association, however, have succeeded in restricting consumer access to information through their control of multiple listing services (MLSs) and the national listing service, Realtor.com, which they feed. Home buyers and sellers are attracted to Realtor.com and listings of major firms because they represent, far and away, the most comprehensive set of listings. As a result, most home sellers feel they must contract with a broker in order to have their house listed on the local MLS and on Realtor.com. But there is often insufficient information on these listings – for example, absence of more than one photo or an address – to allow consumers to shop on their own. So, most home buyers feel they must utilize the services of a broker to gain access to complete information about listings.

Furthermore, consumers are denied full information about properties for sale because these listing services discriminate in subtle or not so subtle ways against nontraditional service

providers. In some areas, for sale by owner (FSBO) properties are listed on MLSs but cannot easily be found in Internet searches. In the past several years, the issue has arisen as to whether brokers should be allowed to restrict the access of other brokers – Internet brokers have been the target – to their listings. As they have on anti-rebate and minimum service laws, the Department of Justice has opposed this practice.

Traditional brokers, who control these listing services, argue that they created the services and should be able to control them. Our response is two-fold: First, home sellers who pay 5-7% commissions should be provided the widest possible exposure to information about the homes they wish to sell. And home buyers, who effectively pay a portion of this commission through higher home prices, as authoritative economic studies have shown, should have ready access to as complete information as possible about these houses. Second, because the MLSs and Realtor.com so dominate listing services, they function as a near-monopoly and should be regulated as a public utility. This regulation should ensure, most basically, more complete and accessible home sale information both to all service providers and to consumers.

A Cockamamie System: The term “cockamamie,” while rarely used today, is a particularly apt adjective characterizing the real estate system. From a consumer perspective, this system is indeed “ridiculous and nonsensical.” In what other product markets in the United States are: prices and related services rarely advertised and even difficult to learn? most prices high and uniform? limited service providers unavailable because of restrictive state laws? widespread covert, and even overt, discrimination against sellers who try to compete on price and/or service? roadblocks to securing key product information through the Internet?

In a report issued in May, CFA characterized this system as a cartel because dominant

sellers have largely succeeded in controlling prices and services. The National Association of Realtors responded that the industry was indeed competitive because there are so many licensed service providers. On the contrary, the huge glut of these providers actually helps maintain the cartel and its control by dominant brokers. Since there are 2.5 million licensed service providers and only about 7 million home sales each year, most brokers are involved in only a handful of sales each year. As a result, most enthusiastically support a system that keeps commission rates high.

Why are there so many licensed providers – from an economist’s point of view, a hugely inefficient marketplace? One must start with extremely low barriers to entry, training sessions typically lasting about two weeks. With such modest licensing requirements, it is remarkable that commission rates are so high, and that new licensees are able to charge the same rate as experienced ones. Many have noted that the NAR has absolutely no interest in changing this system that produces about \$100 million in income from the membership fees they charge, which service providers must pay in order to get full access to MLSs and Realtor.com.³ As a broker wrote to us only last week:

Why have Realtor associations, with all their money and lobbying power failed to demand increased educational requirements to enter or remain in the business? The answer is painfully and sadly obvious. It is \$84 in annual fees multiplied by 1.3 million members. National Association of Realtors has nothing to gain and much to lose by raising standards and it will use its powerful lobbying force to ensure that efforts to do so are defeated.

Dominant brokers support this system because they compensate their salespersons using commissions, not salaries, so benefit from having the largest possible sales forces that are at least somewhat productive.

Dominant Brokers Regulate the Industry

State Regulation: In most states, the residential real estate brokerage industry is regulated by state real estate commissions or boards. The primary function of these bodies is to decide on licensing requirements, issue licenses, and ensure compliance with these requirements. That would be fine if the requirements largely served consumers interests. But they do not because, as a study CFA released last week (and featured in Ken Harney's most recent nationally syndicated housing column) reveals, most of these commissions and boards are dominated by practicing brokers.⁴

Our study revealed, first, that more than two-thirds of real estate commissioners are required by statute to be active real estate salespeople, brokers, or licensees. The actual participation of these service providers is even more extensive. We found that nearly four-fifths of all commissioners earn a living through real estate transactions, with seven in ten being real estate brokers or salespeople. Only 13 percent of the commissioners appeared to have no close ties with the industry. (For 8 percent of the commissioners, we could not identify an affiliation.)

Large national and regional firms are well-represented on the real estate commissions and boards. More than one-fourth of all broker commissioners work for one of the four largest national residential real estate brokerage firms – Cendant/NRT (Coldwell Banker, ERA, Century 21, Sotheby's among others), REMAX, Prudential, and GMAC. And nearly one-tenth of all broker commissioners work for large regional firms that often dominate local markets.

This industry domination of state regulation harms consumers both through omission – what they fail to do – and commission – their initiatives that harm consumers. Consumer

³ National Association of Realtors, 2004 Internal Revenue Service Form 990 at line 3.

complaint services are either not adequately publicized (e.g., Texas) or they do not have adequate resources to handle mounting complaint levels (e.g., California). Furthermore, few states rigorously enforce required disclosure laws. In 2005, according to an NAR report, more than one-half of recent homebuyers surveyed said that they either did not receive any written disclosure or did not receive it at the proper time.⁵ In addition, commission efforts to help home sellers and buyers proactively are extremely limited or nonexistent.

On the other hand, some real estate commissions have actually taken the initiative to restrict broker competition. Several commissions, for example, endorsed and even actively supported minimum services laws. Our report contains four case studies – Iowa, Kentucky, New Mexico, and Texas – in which the support of real estate commissions contributed significantly to the passage of regulatory or statutory changes establishing discriminatory minimum services.

To remedy this egregious situation, our report strongly recommends that states prohibit practicing brokers from serving as commissioners. In Illinois, for example, real estate regulation is overseen by the Commissioner of Banks and Real Estate, who hires a Director and Deputy Director of Real Estate.⁶ These public officials are advised by a Real Estate Administration Disciplinary Board. But none of these officials or Board members are permitted to be licensed as real estate agents. To serve as an official or Board member, practicing brokers must surrender their license for the duration of their public service. An even more desirable regulatory system would allow brokers to serve on advisory groups but allow fulltime professionals to regulate brokerage services. That would make regulation of these services more like the regulation of other services such as insurance and utilities.

⁴ See Consumer Federation of America, “State Real Estate Regulation: Industry Dominance and Its Consumer Costs,” July 2006.

⁵ Evans, Blanche, “Agent Disclosure Worse than Ever,” *Realty Times*, January 24, 2006.

Federal Regulation: Given the domination of state regulatory bodies by the industry, it is fortunate that consumers have federal agencies – particularly the Department of Justice, the Federal Trade Commission, and the Government Accountability Office – that are concerned about their interests. Though somewhat dated, the 1983 study of the industry by the FTC remains the most careful and comprehensive study of the industry and its anti-competitive features. Just last year, the GAO released an excellent analysis of the current residential real estate brokerage system that perceptively identified key barriers to competition. Just last week, the FTC announced a consent agreement with the Austin Board of Realtors to eliminate the practice of segregating non-traditional real estate listings of properties from internet websites.⁷ But the acknowledged regulatory leader in trying to prevent dominant brokers and their trade association from increasingly restricting competition through limiting MLS information, anti-rebate laws, and minimum service statutes has been the Department of Justice. CFA and AGHA are very grateful to these three agencies who have demonstrated they are committed to ensuring that the American free enterprise system is indeed free.

A Congressional Role: Given the capture of state regulation by the industry, Congress should consider giving federal regulators a more explicit and authoritative mandate for regulating residential real estate brokerage services. After all, increasingly local brokerage markets are dominated by powerful national players, and they work closely with large regional firms to dominate the NAR and its affiliates. Moreover, the Internet is a mechanism that allows these services to more frequently be offered at the national level. Industry-dominated state regulators should not be permitted to retard the progress of Internet-business models that are

⁶ Illinois Real Estate License Act of 2000, 225 ILCS 454, especially Article 25, Administration of Licenses.

revolutionizing other product-related marketplaces. As the national regulator of unfair and deceptive sales practices, the FTC is the most logical agency to be given increased responsibility and authority.

Extremely helpful to federal regulators would be a study on key industry practices relating to rates and multiple listing services. In its 2005 study, the GAO reported that “comprehensive data do not exist” on the pricing of real estate services. There is even less information available on the real functioning of multiple listing services.

The following information on rates would assist federal regulators:

- Extent to which rates are advertised and by what types of brokers.
- Any evidence of low-cost brokers being unable to place ads publicizing low rates because of pressure from traditional brokers.
- Extent to which rates are disclosed to potential clients.
- Extent to which home sellers can negotiate rates down.
- Actual commission rates charged, and how they vary by size of firm, by type of firm, by price of home, by specific services provided, by type of representation or facilitation, and by “double-dipping” by individual brokers or in-house sales.

And the following information on multiple listing services would also be helpful to these regulators:

- What is the relation of the NAR and its influential members to these listing services?
- Must a service provider belong to the NAR or its local affiliate in order to gain full access to a MLS?
- Will these MLSs equally list all properties submitted by member brokers, including FSBOs?

⁷ See Federal Trade Commission, Analysis of Agreement Containing Consent Order to Aid Public Comment, *In the Matter of Austin Board of Realtors*, File No. 0510219, July 13, 2006.

- Will these MLSs equally supply information on all listings to all member brokers, including low-price and Internet brokers?
- What information on MLSs is not provided in Internet searches? What information is not provided to clients of member brokers?
- Are there are restrictions on lock-box services related to MLS membership?
- How would giving consumers direct access to MLS information on listings for a reasonable fee affect the functioning of the list services?

Such a study would most logically be undertaken by the FTC. This agency has not only good research capacity but also past experience in studying residential real estate brokerage services.