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Report Calls for End of Commission 'Price Setting'

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Why is it that rookie agents who just received their licenses are able to charge the same fees as their colleagues – many of whom have decades of experience and have closed hundreds of deals?

Why is it that agents who bust their butts – not to mention, spend a ton of money – to market a property for sale are paid the same as glorified chauffeur-agents who do little more than drive you from house to house until you find one that titillates your heartstrings?

It's because the real estate commission rates are just one step below fixed, according to a new report from the Consumer Federation of America.

The study of more than 10,000 sales in the eastern United States found that agent commissions are "highly uniform." But while stopping just short of saying rates are fixed, the report's author, Stephen Brobeck, told reporters during a telephone news conference that "if rates are all similar, clearly there is price setting going on."

Commissions are supposed to be negotiable, and technically, they are. But only to a small degree. In another CFA report two years ago, Brobeck found that only 1 in 4 agents were willing to bargain with their clients. The rest – 75 percent – essentially said, "No way – this is what we charge; take it or leave it."

"The current commission system is designed to thwart price competition among agents," Brobeck said.

'Highly Uniform' Fees

That seems to be the case in most of the 21 cities analyzed by the consumer watchdog group. In all but one – Brooklyn being the lone outlier – the sales fee taken by buy-side agents ranged between 2.5 percent and 3 percent. Only in Chicago, Indianapolis and New Orleans did a significant minority of agents charge less than 2.5 percent.

But in eight cities – Atlanta; Baltimore; Columbus, Ohio; Grand Rapids, Michigan; Hartford, Connecticut; Roanoke, Virginia; Memphis; and Minneapolis – 80 percent or more of the sales were charged identical rates. In Grand Rapids, a staggering 95.8 percent of the buy-side agents were paid the same rate.

Most buyers don't know how the agent who helped find their new house is compensated. And most don't care. If asked, agents say they're paid by the seller. And that's often good enough for the buyers.

But it is important to understand how commissions work. Typically, the seller's agent lists the house at a set fee, usually between 5 percent and 6 percent of the sales price. If the listing agent also secures the buyer, they keep the entire charge. But if another agent brings the buyer to the table, the commission is split – generally down the middle.

Buyers and sellers pay about $100 billion a year in commissions. But Brobeck is convinced that if the fees are paid separately, that figure could eventually slip by $20 billion to $30 billion.

Calls to Expand on NAR Policy

Recently, the National Association of Realtors adopted a new policy that allows – but does not require – listing agents to publish on their websites the share of the commissions that are paid to buy-side agents. The idea is to prevent buy-siders from claiming their services are free.

But Brobeck wants to go further by uncoupling commissions so that sellers pay their agents and buyers pay theirs. And others seem to agree: Both the Cato Institute and the Brookings Institution have published studies arguing for untying the fees.

The NAR's new rule "will help consumers," Brobeck said, but only to a small degree, because it only tells them how commissions are split. Going further and actually uncoupling the charges would spur greater rate competition, he argues.

Buy-side agent compensation is currently “baked into” the listing contract – and, since many sellers add the agent’s commission into their sales prices, into the cost of the house itself. Under a new system, it “would instead be negotiated by buyers,” the report said.

“The only effective way to prod price competition is to uncouple,” Brobeck explains. It would free agents “from the shackles of current industry rules” that force them to charge typical rates, and eventually there would be “a much wider” variation in not only rates, but also service options that reflect an agent’s experience and the amount of effort they are willing to exert.

A Win for Buyers and Sellers?

And, over time, the fees would decline, Brobeck believes – for both sellers and buyers. With uncoupling, he thinks the commission on a house listed for $380,000 – the average list price in October, according to Realtor.com – could eventually fall by as much as 2 full percentage points. That means the total commission would drop from $20,900 to $13,300: a reduction of $7,600 that would be shared equally by seller and buyer.

That would mean, though, that at a time when many buyers are struggling to come up with a down payment, they would need even more cash to close because they’d have to pay their agents from their own funds.

But Brobeck scoffs at that argument, saying because sellers tend to pack their selling costs into their asking prices, buyers “won’t pay any more in gross.” And since the extra cost is typically mortgaged along with house itself, they won’t be paying interest on their share of the sales commission for 30 years, either.

Still, the NAR said in a statement that forcing buyers to take on the additional out-of-pocket expense “would cause added financial hardship and could freeze out many from the market entirely, particularly first-time and low- and middle-income buyers. It could also force buyers to forgo professional help during what is likely the most complex and consequential transaction they’ll make in their lifetime.”

But Brobeck said that if untied, commission rates would tumble, and discount agents who offer a choice of services based on their abilities would flourish.

“In my mind,” he said, “there’s no issue at all.”