
The Price of Residential Real Estate Brokerage Services: A Review of the Evidence, Such as it is

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Is Brokerage Competitive? -- NO

Wall Street Journal, New Republic, USA Today, Computer World, Washington Post, Time, Forbes, "Tonight Show," "Today Show"

- commission rates are “too high” for the work involved
 - rates are sticky downward even as technology reduces broker’s cost
 - rates are higher in the U.S. than other countries
 - NAR and state associations lobby vigorously for laws to restrict competition (minimum rates and service requirements)
 - NAR has successfully lobbied Congress to prohibit banks from entering the real estate brokerage business
 - NAR restricts access to the MLS by discount and internet brokers
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Is Brokerage Competitive? – YES

Industry Advocates

- commission rates are highly variable and have been declining for over a decade
 - the number of real estate brokers is increasing, and entry is easy
 - brokerage practices and state regulations are hardly limiting the market, since existing home sales are at record volumes
 - real estate brokers bear substantial marketing costs with no guarantee of a sale
 - bank entry into brokerage will benefit banks and the Federal treasury, but not consumers
 - homes are unique; other goods sold over the internet are “a commodity where one share or ticket is the same as the next”
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Other Papers at This Conference

- Hahn/Litan/Gurman: anticompetitive trade restraints
- Miller: international comparisons
- Lande: how can a cartel can be effective with free entry into the industry?

My paper excludes these subjects

Reviewing the Literature

Time-series: national average data on brokerage commissions

Cross-sectional: academic literature on commissions in various markets

There is not much data

Therefore, there is an overwhelming preponderance of theoretical studies in the academic literature

Different models have different predictions

Some relationships have theoretically indeterminate signs

Time-Series Data: REAL Trends

Apparently the only source of information over time

Not publicly available, and becoming less so

But, secondary sources report average commission rates for one or two years and identify REAL Trends as the source of the information

Average Commission Rates (REAL Trends)

Year	Rate	Source
1991	6.1%	Hahn, Litan & Gurman
1992	---	
1993	---	
1994	---	
1995	5.98%	Lehmann
1996	---	
1997	---	
1998	5.5%	GAO
1999	---	
2000	5.48%	Lehmann
2001	5.4%	Roberts & Mara
2002	5.1%	Roberts & Mara
2003	5.1%	Roberts & Mara; Lehmann
2004	5.1%	Hahn, Litan & Gurman; GAO

REAL Trends Data Limitations

- **More expensive homes**
- **Largest firms**
- **“Average” of whom?**

Firm Size	2002 Average Rate	2003 Average Rate
Top 50	5.04%	5.06%
Top 100	5.08%	5.07%
Top 101-500	5.26%	5.24%
Up-and-Comers	6.20%	5.36%
“The Average”	5.1%	5.1%

Interpreting the REAL Trends Data

- Home prices have risen while commission rates have apparently been falling
 - Nominal home prices have increased faster than commission rates have fallen
 - BUT: adjusting home prices for inflation –
 - The real dollar value of the average commission declined from 1991 through 1998, and then rose in most years until 2004
 - Not until 2003 did the average real commission exceed the 1991 level
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Average Commission per Sale

Year	Average Commission	Average Existing Home Price	Average Commission	Average Real Commission (2004 \$)
1991	6.1%	\$128,400	\$ 7,832	\$10,862
1992	---			
1993	---			
1994	---			
1995	5.98%	\$139,100	\$ 8,318	\$10,310
1996	---			
1997	---			
1998	5.5%	\$159,100	\$ 8,750	\$10,140
1999	---			
2000	5.48%	\$176,200	\$ 9,656	\$10,592
2001	5.4%	\$185,300	\$10,006	\$10,672
2002	5.1%	\$199,200	\$10,159	\$10,667
2003	5.1%	\$215,000	\$10,965	\$11,257
2004	5.1%	\$236,000	\$12,067	\$12,067

The Cross-Sectional Literature

- Half a dozen studies, mostly old
 - Data from 1975 to 1992
 - GAO: “Our review cites a number of academic studies that date back many years because, in large part, there is not a large body of more recent research on the real estate brokerage industry.”
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Research Design

- Professors of real estate and related fields have collected transaction data in the areas where they live and work
 - “All real estate markets are local”
 - All research on real estate brokerage commissions is local
 - Almost all research on real estate brokerage commissions is done by local faculty
 - Therefore: almost all research pertains to college towns: Baton Rouge, Knoxville, and Lincoln
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Larsen and Park – Lincoln, 1986

Distribution of commission rates

selling broker's share
(nearly always 40% of commission)

number of sales

2.0%	25
2.4%	43
2.5%	1
2.8%	362 - 84%
3.0%	2

- Mean: 2.71% (6.8% for full commission)
- Standard deviation: 0.21% (0.5% for full commission)

Comparing the Data

Authors	Place	Dates	Mode	Mean	Standard deviation
Larsen & Park	Lincoln	1986	2.80%	2.71%	0.21%
Goolsby & Childs	Knoxville	1983/1987	2.40%	2.36%	0.33%
Sirmans & Turnbull	Baton Rouge	1985-1992	N.A.	N.A.	N.A.

FTC Survey 1975-1979

- HUD-1 forms
 - 16 different cities
 - 23 samples for city/years
 - Includes both new and existing homes
 - Includes both “co-op” and “non-co-op” sales
 - Actual commission rates on transactions
 - Results:
 - Typical commission is 6% or 7%
 - Concentrations at modes (around 70%)
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Distributions of commission rates

City/year	Mode	Concentration at mode	Mean	Standard deviation
St. Louis, 1979	6%	85%	5.88%	0.45%
Washington, 1975	6%	68%	5.91%	0.52%
Columbus, 1978	6%	56%	6.26%	0.64%
Jacksonville, 1979	7%	30%	6.56%	0.82%

Findings: Variables Affecting Commission Rates

	Higher Price?	New Home?	Co-op Sale?	Longer Time on Market?
Goolsby & Childs	Higher rate	Lower rate	No effect	No effect
Sirmans & Turnbull	Lower rate	Lower rate	Not studied	No effect
Carney (FTC)	Lower rate	Lower rate	Higher rate	Not studied

Limitations/Concerns

- Goolsby & Childs multicollinearity
 - Larsen & Park focus: time on market, not commission rate
 - Sirmans & Turnbull contract commission rate, not actual rate
 - Carney consistency with FTC
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Comparing Cross-Section & Time Series - #1

- Sirmans & Turnbull: Rate is lower when market is strong
- REAL Trends: Rate is lower as market strengthens

Consistent, but:

- Sirmans & Turnbull stop in 1992
 - REAL Trends starts in 1991
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Comparing Cross-Section & Time Series - #2

- Sirmans & Turnbull report higher commission rates for large firms
 - Therefore, possible bias in REAL Trends survey?
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Conclusions from the Literature: Implications for Commission Rate Rigidity

- Maybe rates are competitive – but maybe not:
 - Rate clustering is consistent with some rate dispersion (both Larsen & Park and FTC)
 - Rates are different for new and existing homes – both are included in every study
 - Rates are different for “co-op” and “non co-op” sales – both are included in most studies
 - Therefore, studies will show dispersion even if rates are fixed for each type of transaction
 - The earlier (FTC) data show more rate dispersion
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Conclusion of this Paper

- Very little evidence
 - Very limited findings
 - Very much more research needed
 - Very much more data needed before meaningful research
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