REAL ESTATE

Anticompetition in Buying and Selling Homes

The National Association of Realtors' market power is hurting Americans' mobility.

BY ROGER P. ALFORD AND BENJAMIN H. HARRIS

The purchase of a home is one of the most important events in a person's life. To many, the market for buying and selling homes may appear competitive, allowing current and aspiring homeowners to freely buy and sell their properties according to market-based principles. In truth, a stringent set of rules and norms dominates the residential housing market, dictating how real estate agents are compensated and whether one can practically sell a home without paying a small fortune in fees. The cost of all this to consumers amounts to tens of billions of dollars a year.

The heart of the problem is the set of rules maintained by the National Association of Realtors (NAR), a powerful trade association representing nearly 1.5 million members. The NAR requires real estate brokers to be members of the association in order to gain access to local networks, known as Multiple Listing Services (MLSs), where houses are posted for sale. Through this requirement, the NAR imposes mandatory rules to limit competition and raise fees paid by homebuyers and homesellers.

The most problematic of these rules is the requirement that sellers pre-determine, before even knowing the buyer, the commission paid to the buyer's agent. This constitutes a "tying" practice, which fixes brokerage prices and stifles competition for commissions. Also, homeowners seeking to sell a home outside the MLS system, including a sale without a real estate agent, must at times overcome a tacit effort by realtors to discourage their clients from buying homes that are not represented by an NAR member. Finally, the rules stifle innovation and promote artificial barriers to entry for nascent online competitors.

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This anticompetitive framework has serious consequences. The tying arrangement inflates realtor fees above their market value, resulting in a massive transfer of wealth from consumers to real estate professionals. Higher realtor fees also impose larger transaction costs, thereby decreasing geographic mobility, deteriorating household wealth, and reducing homeownership. Furthermore, because of the anticompetitive restrictions, real estate agents have little incentive to differentiate themselves and compete on price. The rules of the realty market also lower state and local tax revenues while depressing attendant markets like mortgage brokerages, moving services, and home renovations.

But there is good news. Developments in the industry are slowly eroding the NAR's dominant position. New entrants provide alternative avenues for consumers to buy homes, reducing the dependence on the existing system. These innovations have slowly chipped away at realtor commissions. In addition, consumers have brought class action suits in federal court to challenge the NAR's practices. These suggest a trend toward greater competition, but they are not enough; without enforcement or regulatory action, widespread threats to competition will continue.

THE PROBLEM

At first glance, the realty market in the United States appears highly competitive. In March 2020, well over 1 million realtors and almost 90,000 brokerages competed for business in local markets. Internet penetration and technological advances have transformed the market, providing consumers the freedom to perform online property searches, instantly receive property estimates, and gather quotes for a range of realty-related services. Large-scale discount brokerages such as Redfin have entered the market and proven viable, often sharing buyers' commissions with consumers. And more recently, alternatives to traditional realty transactions, such as "ibuyers" that offer quick sales at steep discount to home values, have gained a small share of the market.

Even with these advances, evidence suggests that the U.S. realty market suffers from a widespread dearth of competition. Unlike traditional monopolies, where willing entrepreneurs face high barriers to entering a market, the realty market is dominated by a consortium of local cooperatives enforcing a series of mandatory rules that keep prices high and suppress more efficient ways of doing business. It is a market where anyone can play as long as he or she adheres to a particular set of anticompetitive rules.

The MLS network enforces these rules through a network of over 800 local cooperatives under which, according to the NAR, "brokers share information on properties they have listed and invite other brokers to cooperate in their sale in exchange for compensation if they produce the buyer." In other words, the MLS serves to coordinate both information sharing and compensation arrangements.

The result is a market dominated by a particular network mandating a way of doing business. To be clear, innovations are occurring: Online listing services such as Zillow, Trulia, and Homes.com give consumers a greater role in searching for homes and lower the value of the labor inputs provided by brokers. Large-scale discount brokerages offer technology-driven solutions with lower commissions. More traditional realty companies have developed matchmaking services where buyers are privately matched with potential sellers without an MLS-listing.

Yet, despite those innovations, the MLS has maintained its market position and broker commissions have remained virtually unchanged for decades. This reality stands in stark contrast to the effects of technological advances in other industries. The introduction of online platforms lowered the cost of trading stocks and transferring funds electronically, decreased the cost of life insurance policies, and eliminated fees collected by travel brokers. The absence of these effects in the realty market can be attributed to the MLS's anticompetitive practices. The expected gains provided by these advances will materialize if free competition returns to the market.

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Suppressing competition / The MLS suppresses competition through three channels. The first relates to the requirement that realtors operating in the MLS adhere to mandatory rules prescribing agents' compensation. The most powerful of these rules, known as "tying," demands that a listing agent (the seller broker) must make a blanket unilateral offer in advance to pay the buyer broker's fee despite not having any information about the agent, the buyer, or the services performed. The tying arrangement means, in effect, that the buyer broker's compensation is paid by the seller, and that fee is predetermined and cannot be negotiated or adjusted.

The second anticompetitive channel, known as "steering," is the tacit practice by agents to avoid lower-commission properties. This practice occurs when agents either encourage their clients to consider high-commission properties or fail to show them homes with lower commissions. Information asymmetry exacerbates the steering concern: buyer and seller agents can view the full menu of possible commissions, while the MLS's mandatory rules prohibit sellers and buyers from knowing the commissions on any of the properties. There is even a mandatory rule prohibiting the MLS service and brokers from disclosing in any way the total commission negotiated between the seller and the listing broker. The result is a system in which agents, without their clients' knowledge and against their best interests, have both the ability and incentive to steer their clients to properties with higher commissions.

The practice of steering has powerful and destructive effects on consumers. A 2017 study of 35,000 real estate agents found that properties offering less than the 2.5% commission—the median rate in the sample—significantly lowered the probability of sale by 5% and raised the time to sale by 12%. A follow-up study found that the effects of steering are more severe in highly concentrated markets dominated by a handful of brokerages. Those findings suggest that agents actively dissuade their clients from considering homes that offer lower commissions; the message to sellers is that offering a lower commission imperils the chances that a listed home will sell.

The third anticompetitive channel is that participants who seek to buy or sell a home without a realtor face steep obstacles to doing so. Sellers hoping to forgo an agent can choose between selling themselves (known as for-sale-by-owner [FSBO]) or paying for MLS-only services that list properties for a nominal fee, although the latter option is not available to sellers in some states that mandate "minimum service requirements" by realtors.

Despite technological advances that would theoretically promote a higher share of FSBO sales and empirical evidence showing that using a realtor does not raise the selling price, the FSBO strategy has yet to gain traction and is employed by only about one in 10 sellers. Here, steering is likely to blame: FSBO sellers who are not on the MLS are easily avoided by realtors who use the MLS as their sole source of available homes, while sellers choosing the MLS-only option are subject to the same tacit steering problems as those with full-service brokers.

The promise that technological gains would disrupt the longstanding realty paradigm has not yet materialized. Increased penetration by discount brokers has done little to reduce the typical fees charged by realtors: Cornell economist Panle Jia Barwick and the Wharton School's Maisy Wong found that the mean commission rate fell just 0.14 percentage points between 2000 and 2018. Despite this competition, brokers remain generally unwilling to negotiate fees: a 2019 survey by the Consumer Federation of America revealed that just 27% of brokers were willing to negotiate their commissions despite not knowing how much they would ultimately be paid for their services.

The situation may be getting worse. While commission rates have declined slightly over time, inflation-adjusted growth in housing prices has been greater. That means realtors are being paid even more per sale than before, despite falling costs because of increased ability to search and cheaper advertising. Indeed, while realtor commission rates have fallen by about 15% over the past two decades, real housing prices have increased by well over 30%.

Is this a problem? / Evidence on the lack of competition begs the question: do higher fees matter? Most households rarely buy and sell homes, after all. In the face of other pressing problems in the housing market, including starkly constrained supply, should policymakers try to upset a market that has been in place for decades?

In a word, yes. The most obvious and first-order concern is a massive transfer in wealth away from consumers. Commissions in the United States are two to three times higher than in other developed countries such as Australia, Canada, Ireland, the Netherlands, and the United Kingdom. In 2019, realtors collected roughly $100 billion in commissions, indicating that U.S. consumers annually would pay about $50 billion less in fees if U.S. realtors charged commission rates in line with international norms.

A related concern is that the high fees inhibit mobility. American mobility has been falling for decades, with annual rates falling by about one-third since the mid-1980s. The trend is rooted in a handful of explanations, but the high costs of buying and selling homes is one of the factors. Prior research has shown that consumers are incredibly sensitive to transaction costs in buying and selling homes; one study found that housing volume fell by 15% when Toronto implemented a 1.1 percentage point transaction tax.

The depressive effects on mobility have myriad second-order effects. Mobility constraints reduce the lifetime earning power of those who are unable to relocate to better jobs. State and local tax revenues from housing transactions are lower. Attendant industries like moving, home renovation, and mortgage brokerages suffer. And innovation in promising new approaches to homebuying, including using tech to better market properties, is stifled.

Fortunately, a series of policy and regulatory reforms can help inject more competition into the housing market.

THE SOLUTION

Artificially high fees and the subsequent drains on mobility and sales volume can be addressed by restoring free competition. The aspiration should be a realty market whereby participants can both choose whether to engage a real estate agent and what level of services to purchase. Importantly, too, consumers should be able to negotiate over fees and agents should be able to compete on price.

There are three primary avenues through which a free market can be established: forced untying of realtor fees, regulatory action against anticompetitive steering, and repeal of state anti-rebate and "minimum service requirement" laws. In addition, barriers to entry erected by the MLS need to be eliminated to provide free competition and allow for greater market penetration by innovative competitors.

Realty market participants should be able to choose whether to engage a real estate agent and what level of services to purchase. They should also be able to negotiate over fees, and agents should be able to compete on price.

Tying / The first reform that is necessary to promote free and fair competition is to eliminate the tying arrangement with realtor fees. The NAR and its MLS network require sellers to make unconditional "blanket unilateral offers of compensation" to buyer brokers that are completely unrelated to the service provided. Sellers are thus forced to pay the commission of buyer brokers long before they even know who will buy the home. The effect of this "Buyer Broker Commission Rule" on consumer welfare is pronounced and unavoidable; seller brokers involved in a sale are required to include the buyer's commission to maintain their own access to MLS listings. Furthermore, the MLS will not publish listings that do not include buyer broker commissions, and in all but one local market it *prohibits* buyers from knowing the compensation offered to their agents.

While this rule does not mandate a set price, it functions to fix prices. As a result, consumers have paid 5%–6% in broker commissions for decades, despite the rise in housing prices during the same period and increased search activity by homeowners through internet databases. Setting the commissions at this level eliminates price competition among brokers because their compensation is predetermined by the seller. While it is possible for new entrants to avoid the MLS network, established realtors boycott or steer their clients away from new entrants who undercut the fixed commission rate, reinforcing compliance with the MLS rules.

As long as the MLS remains a prominent feature of the housing market, it is essential for the law to restore competition within the network. To do this, realtor tying requirements need to be eliminated so brokers will compete with each other on commission fees. The optimal way to eliminate tying would be a court-ordered injunction or regulatory action that eliminates the tying arrangement. By using one of those options, the government can make it clear that antitrust law does not permit conditioning MLS access on agreeing to an anticompetitive conspiracy to keep commissions high. If realtor fees were untied, competition between the MLS and online platforms would produce downward pressure on price while promoting innovation and consumer welfare. Real estate agents, too, would have more freedom to offer various fee structures and service levels to their clients.

Steering / Untying of brokers fees would halt steering within the MLS, but more action needs to be taken to protect those who want to avoid the MLS altogether. The prices of FSBO and other non-MLS listings are generally lower because they do not include the typical 5%–6% commission paid to seller and buyer brokers. Regulation eliminating the practice of steering from FSBO and other non-MLS listings would provide a downward pressure on home prices because buyer brokers would not be guaranteed commissions. To achieve this, regulators should take action to eliminate the practice of buyers' agents steering their clients away from FSBO and non-MLS listings so that sellers do not face discrimination simply because they are selling a property without an agent or outside of the MLS network.

Regulation targeting steering would also address potential violations of fiduciary duty. Brokers have a duty to act in their client's best interest and find optimal housing options. The current guaranteed commission structure motivates brokers to buy and sell properties that pay the best commission for the time expended. This creates perverse incentives that encourage steering to higher-priced properties with higher commissions. FSBO properties and other non-MLS listings often do not provide large commissions, so brokers have a strong incentive to show MLS-listed houses with guaranteed commissions. These incentives are exacerbated because consumers are unaware of the cost of commissions because the NAR does not require disclosure of commissions.

Anticompetitive restrictions / The final recommendation to enhance competition is for states to repeal laws imposing anticompetitive restrictions on the real estate market. One example of these regulations is anti-rebate laws. Discount brokers developed a rebate system in which buyers are reimbursed one-third to one-half of broker commissions in an effort to introduce price differences among brokers while sidestepping the MLS-required commissions. Consumers are then able to compare brokers using price, quality, and service, which incentivizes brokers to compete.

In response, realtors effectively lobbied a handful of states to pass laws outlawing rebates. The sole purpose of these anti-rebate laws is to inhibit price competition and protect realtor profits; there is no pro-competitive justification articulated for anti-rebate laws. A repeal of these state laws is necessary to lift barriers to price competition, ensure free negotiation, and increase consumer welfare through price savings.

Several states have also enacted "minimum service requirements" laws that specify tasks brokers must perform for clients. These laws limit consumer choice by imposing a minimum bundle of services that clients must purchase. By imposing these requirements, a consumer may be forced to pay more for unnecessary services or decide against using a broker at all. These laws also reduce competition among brokers because "fee-for-service" brokers that tailor their services to a client's needs are prohibited from competing with brokers offering the state-required minimum level of service. For FSBO and other non-MLS properties, these state laws force consumers to pay for services they may not need and otherwise would not purchase. A repeal of these state laws would eliminate anticompetitive prohibitions that distort the real estate market in these states.

These reforms would force a dramatic change in the U.S. realty market. Homesellers would purchase services from brokers offering different levels of service at different prices. Homebuyers would do the same. Either could choose to forgo realty services altogether if they desired. Sellers would only pay the commission of their own agent rather than also paying for the buyer's agent. In practice, this would likely mean real estate agents would be paid by the hour or according to a fee schedule for the service performed. In other words, the realty market would operate the same way as virtually every other market for services, where consumers select the right level of service to meet their needs and then select from a menu of providers to meet that need.

CONCLUSION

As many who have ever bought or sold a home can attest, the United States housing market embraces a peculiar set of incentives and practices that sets it apart from virtually every other market in the economy. Homesellers not only pay the buyer's agent commission, they stipulate what that commission will be before even knowing who will buy their home or the value of the agent's services. Buyers generally only learn of their agent's compensation—in effect, what they are paying their agent in the form of higher housing prices—when presented with the closing statement.

Careful academic work has established that this system ultimately burdens consumers, as sellers must offer high levels of commissions to maximize the chances their home will be sold in a timely fashion. Those who sell a home without an agent face high barriers to doing so, and innovative new firms seeking to sidestep the established network of realtors face steep barriers to entry.

The cumulative costs are enormous, measuring in the tens of billions of dollars every year. But the real price is not just higher fees, but diminished volume of housing sales. In effect, the high cost of buying and selling a home acts as a tax on mobility, penalizing a worker who wants to move for a better job, or parents who want to relocate to build a better life for their family. Companies that depend on housing volume, like moving services or mortgage brokers, similarly bear a disproportionate share of the burden.

It does not take much creativity to imagine a different system. By untying the buyer's and seller's compensation offers, the fee structure for realty services would mimic virtually every other market for professional services in the United States. Consumers could choose the level of service that fits their needs. Buyer's agents would be paid by the buyers and seller's agents would be paid by the sellers. The likelihood of selling a home would not depend on what the seller pays the buyer's agent.

This new system could revolutionize the residential housing market. New firms seeking to do business outside the MLS might finally gain traction. Innovative real estate agents could offer consumers new frameworks for compensation, while more successful agents could be free to compete on price. Homeowners could sell their home without an agent if they liked.

The most important changes would be broader. Mobility would increase, which is an especially important factor given the millions now unemployed because of COVID-19. Household wealth would rise as homesellers would retain more of their home equity. And the American dream of homeownership would become more attainable as the cost of getting into a home would fall.

With regulators paying increased attention to this issue and several class action lawsuits pending, we are optimistic change will come. For the sake of American consumers and the U.S. housing market, we hope it comes quickly. R

READINGS

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