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Report to the Committee on Financial Services, House of Representatives

August 2005

REAL ESTATE BROKERAGE

Factors That May Affect Price Competition

GAO

Accountability ★ Integrity ★ Reliability

GAO-05-947

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Highlights

Highlights of GAO-05-947, a report to the Committee on Financial Services, House of Representatives

August 2005

REAL ESTATE BROKERAGE

Factors That May Affect Price Competition

Why GAO Did This Study

Consumers paid an estimated $61 billion in residential real estate brokerage fees in 2004. Because commission rates have remained relatively uniform—regardless of market conditions, home prices, or the effort required to sell a home—some economists have questioned the extent of price competition in the residential real estate brokerage industry. Further, while the Internet offers time and cost savings to the process of searching for homes, Internet-oriented brokerage firms account for only a small share of the brokerage market. Finally, there has been ongoing debate about the potential competitive effects of bank involvement in real estate brokerage.

GAO was asked to discuss (1) factors affecting price competition in the residential real estate brokerage industry, (2) the status of the use of the Internet in residential real estate brokerage and potential barriers to its increased use, and (3) the effect on competition and consumers of residential real estate brokerage by state-chartered banks in states that permit this practice.

www.gao.gov/cgi-bin/getrpt?GAO-05-947.

To view the full product, including the scope and methodology, click on the link above. For more information, contact David G. Wood at (202) 512-8678 or woodd@gao.gov.

What GAO Found

The residential real estate brokerage industry has competitive attributes, but its competition appears to be based more on nonprice variables—such as quality, reputation, or level of service—than on brokerage fees, according to a review of the academic literature and interviews with industry analysts and participants. One potential cause of the industry's apparent lack of price variation is the use of multiple listing services (MLS), which facilitates cooperation among brokers in a way that can benefit consumers but may also discourage participating brokers from deviating from conventional commission rates. For instance, an MLS listing gives brokers information on the commission that will be paid to the broker who brings the buyer to that property. This practice potentially creates a disincentive for home sellers or their brokers to offer less than the prevailing rate, since buyers' brokers may show high-commission properties first. Some state laws and regulations may also affect price competition, such as those prohibiting brokers from giving clients rebates on commissions. Although such laws and regulations can protect consumers, the Department of Justice and the Federal Trade Commission have argued that they may also unnecessarily limit competition and reduce consumers' choices.

The Internet has changed the way consumers look for real estate and has facilitated the creation and expansion of alternatives to traditional brokers. A variety of Web sites allows consumers to access property information that once was available only by contacting brokers directly. The Internet also has fostered the growth of nontraditional residential real estate brokerage models, including discount brokers and broker referral services. However, industry participants and analysts cited several obstacles to more widespread use of the Internet in real estate transactions, including restrictions on listing information on Web sites, some traditional brokers' resistance to cooperating with nontraditional firms, and certain state laws and regulations.

Although about 30 states potentially authorize state-chartered banks or their operating subsidiaries to engage in some form of residential real estate brokerage, few banks in these states appear to have done so. GAO's contacts with seven banks engaged in brokerage in two states found that they were located in small communities with few other brokerage options, and that their brokerage services did not differ significantly from those of other local real estate brokers. In general, because residential real estate brokerage by state-chartered banks appears to be so limited, its effect on competition and consumers has likely been minimal.

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Abbreviations

DOJ	Department of Justice
FTC	Federal Trade Commission
MLS	multiple listing service
NAR	National Association of Realtors®
VOW	Virtual Office Web site

United States Government Accountability Office
Washington, D.C. 20548

August 31, 2005

The Honorable Michael G. Oxley
Chairman
The Honorable Barney Frank
Ranking Minority Member
Committee on Financial Services
House of Representatives

The fees paid for residential real estate brokerage—the bringing together of buyers and sellers of homes and the provision of related services by licensed brokers and agents—have increased as home prices have risen in recent years, well beyond the rate of general price inflation. While comprehensive data do not exist, REAL Trends, an industry source, estimates that in 2004 consumers paid about $61 billion in real estate brokerage fees related to home sales, up from approximately $43 billion in 2000.[1] Payments to brokers are typically percentage commissions, or a percentage of the sales price of the home. An observed tendency toward uniform commission rates regardless of local market conditions has led many economists and other observers to question the level of price competition—rivalry among firms to attract clients on the basis of price—in the residential real estate brokerage industry.

The emergence of the Internet offers the potential to reduce costs by generating efficiencies and new ways of doing business. While many consumers now use the Internet to search for homes and related services, such as mortgages, Internet-oriented brokerage firms still represent a small share of the market.[2] This has raised questions concerning potential institutional, legal, and other barriers to greater "e-commerce" in real estate. Additionally, there has been an ongoing debate on the potential competitive effects of allowing federally chartered banks and financial holding companies to engage in real estate brokerage. Because some states

[1]REAL Trends is a company providing news, research, and information-based services to the residential real estate industry. The company was cited in industry press and among industry participants we interviewed as providing the best available data on residential real estate brokerage fees. We considered REAL Trends' estimates to be sufficiently reliable based on the competency of the source producing the estimates and the reasonableness of the estimates.

[2]For the purposes of this report, the term "Internet-oriented brokerages" refers to brokerage firms whose business model depends largely on the Internet. Other brokerage firms may also use the Internet to varying degrees.

already permit brokerage by state-chartered banks, the experience of those states may help inform this debate.

You requested that we review issues related to price competition and the use of information technology in the residential real estate brokerage industry. This report discusses (1) factors affecting price competition in the residential real estate brokerage industry, (2) the status of use of the Internet in residential real estate brokerage and potential barriers to its increased use, and (3) the effect on competition and consumers of residential real estate brokerage by state-chartered banks in states that permit this practice.

In addressing these topics, we reviewed academic literature on the structure and competitiveness of the residential real estate brokerage industry. (A bibliography of selected literature reviewed appears at the end of this report.) We did not collect original data on residential real estate brokerage fees or attempt to analyze the extent of price competition within any specific market. We interviewed and obtained relevant documents from industry analysts and officials of real estate brokerage and banking trade associations, including the National Association of Realtors® (NAR); national associations of state real estate and banking regulators; and the Department of Housing and Urban Development, the Department of Justice (DOJ), and the Federal Trade Commission (FTC). We also interviewed officials of 10 residential real estate brokerage firms and franchisors, including 2 companies with major national franchise operations, 1 full-service brokerage firm, 2 Internet-oriented full-service discount brokerage firms, 2 companies that franchise limited-service discount brokerage offices, and 3 Internet-oriented information and referral companies. The brokerages and franchisors we spoke with included both small and large firms, and these firms relied on the Internet to varying degrees. Because we spoke to a limited number of brokerage firms and franchisors, their views cannot be interpreted as being representative of all such firms. We also reviewed the activities of two states, Iowa and Wisconsin, where some banks are active in residential real estate brokerage. We spoke with these states' banking regulatory agencies and real estate trade associations, as well as with seven banks in these states that engage in residential real estate brokerage. The information on these seven banks is intended to be illustrative and cannot be generalized to state-chartered banks nationwide. We also reviewed relevant selected state laws and regulations and state and federal court decisions. The scope of our work was limited to residential real estate brokerage and did not address other aspects of real estate transactions, such as mortgage financing, title search and insurance, or the settlement process.[3] We performed our work primarily in Boston, Massachusetts; Chicago, Illinois; and Washington, D.C., between January and July 2005. We performed our work in accordance with generally accepted government auditing standards, except that we did not seek agency comments on this report because we did not review agencies' programs. However, we provided selected portions of a draft of this report to DOJ and FTC for their technical comments, which we incorporated where appropriate.

Results in Brief

A number of factors can influence the degree of price competition in the real estate brokerage industry. Some economists have observed that while the industry has attributes associated with active competition—a large number of relatively small firms and ease of entry—it has displayed more evidence of competition on the basis of nonprice factors, such as reputation or level of service, than on price. Although there are no comprehensive data on brokerage fees, past analyses and anecdotal information suggest that commission rates have persisted in the same range—roughly 5 percent to 7 percent of a property's selling price—over long periods, regardless of local market conditions, housing prices, or the cost or effort required to sell different properties. Our review of the academic literature and interviews with industry analysts and participants suggest several potential causes of this relative lack of price variation. First, multiple listing services (MLS)—the local organizations through which brokers share information about properties—may encourage price conformity by, for example, showing the commission that buyers' brokers will receive for cooperating in the sale of a property. Because, all else being equal, buyers' brokers have less incentive to show properties that offer them a lower commission, this system may discourage brokers from offering less than the prevailing commission rate. In addition, sellers' brokers may offer a lower share of the sales commission to buyers' brokers who advertise discounted prices than to other brokers. Further, some states prohibit brokers from giving clients rebates on commissions, and some states require or are considering proposals to require brokers to provide consumers with a minimum level of service. Although such laws may offer some consumer protections, DOJ and FTC have argued that they can potentially prevent price competition or reduce consumers' choice of brokerage services.

[3]Hereafter, for purposes of this report, the term "real estate brokerage" refers to residential real estate brokerage.

The Internet has increased consumers' access to information about properties for sale and facilitated new approaches to real estate transactions. Many brokers post on Web sites information—in varying degrees of detail—about properties they have contracted to sell ("listings"), enabling consumers to obtain such information without consulting a real estate broker. The Internet also has fostered the creation or expansion of a number of Internet-oriented real estate brokerage and related firms, including some discount brokers and services that refer clients to brokers. However, several potential obstacles to further expansion of the Internet's role in real estate brokerage exist, including the extent to which listing information is made available for brokers to post online. For example, NAR has considered allowing listing brokers to decide which other brokers may display their MLS listings online. Some brokers' refusal to allow their listings to be posted on certain brokers' Web sites could constrain potential buyers' Internet searches for properties for sale, potentially limiting the business of Internet-oriented brokers. Internet-oriented discount brokers may also face resistance from traditional brokers and may be affected by the state laws that prohibit or restrict commission rebates to consumers. Finally, other factors, such as the lack of a uniform sales contract for residential real estate and of a uniform technology to facilitate related processes—such as inspection, appraisal, financing, title search, and settlement—may inhibit the use of the Internet for accomplishing the full range of activities needed for real estate transactions.

Approximately 30 states have laws or regulations that potentially authorize state-chartered banks or their operating subsidiaries to engage in real estate brokerage under some circumstances. However, only a limited number of banks in these states appear to have used this authority, so the effect on competition and consumers has likely been minimal. On the basis of our review of state statutes and regulations identified by two national associations, at least 5 states and the District of Columbia provide relatively clear authority for banks or their subsidiaries to engage in real estate brokerage. Laws in certain other states may also provide such authority, but these laws are ambiguous or subject to regulatory interpretation. The exact number of state-chartered banks engaged in real estate brokerage is unknown but appears to be limited, according to trade and regulator associations in the banking and real estate industries. The seven banks we spoke with told us that they offered brokerage services in small communities and provided an additional option for local customers. These banks said that real estate brokerage was a small portion of their business, and that their brokerage services and pricing did not differ significantly from those of other local brokerage companies.

Background

Traditionally, real estate brokers have offered a full, "bundled" package of services to sellers and buyers, including marketing the seller's home or assisting the buyer's search, holding open houses for sellers and showing homes to buyers, preparing offers and assisting in negotiations, and coordinating the steps to close the transaction. Because real estate transactions are complex and infrequent for most people, many consumers benefit from a broker's specialized knowledge of the process and of local market conditions. Still, some consumers choose to complete real estate transactions without a broker's assistance, including those who sell their properties on their own, or "for-sale-by-owner."

For many years, the industry has used a commission-based pricing model, with sellers paying a percentage of the sales price as a brokerage fee. Brokers acting for sellers typically invite other brokers to cooperate in the sale of the property and offer a portion of the total commission to whoever produces the buyer. Agents involved in the transaction may be required to split their shares of the commission with their brokers.[4] Under this approach, brokers and agents receive compensation only when sales are completed. Common law has generally considered both brokers cooperating in the sale of a home to have a fiduciary responsibility to represent the seller's interests, unless the buyer's broker has specifically agreed to represent the buyer's interests.[5]

In recent years, alternatives to this traditional full-service brokerage model have become more common, although industry analysts and participants told us that they still represent a small share of the overall market. Discount full-service brokerages charge a lower commission than the prevailing local rate, but offer a full package of services. Discount limited-service brokerages offer a limited package of services or allow clients to choose from a menu of "unbundled" services and charge reduced fees on a commission or fee-for-service basis.

[4]Brokers who operate as part of a franchise may also be required to share a portion of their commission revenue with the franchise, in payment for using the brand name and other services.

[5]T.J. Miceli, K.A. Pancak, and C.F. Sirmans, "Restructuring Agency Relationships in the Real Estate Brokerage Industry: An Economic Analysis," *Journal of Real Estate Research*, vol. 20, no. 1/2 (2000). Some states require consumer consent if the buyer's broker is to represent the seller's interests; other states prohibit this form of agency representation.

Most local real estate markets have an MLS that pools information about homes that area brokers have agreed to sell. Participating brokers use an MLS to “list” the homes they have for sale, providing other brokers with detailed information on the properties, including how much of the commission will be shared with the buyer’s agent. An MLS serves as a single, convenient source of information that provides maximum exposure for sellers and facilitates the home search for buyers. Each MLS is a private entity with its own membership requirements and operating policies and procedures. According to NAR, approximately 900 MLSs nationwide are affiliated with the trade association, whose more than 1 million members represent approximately 60 percent of all active licensed real estate brokers and agents. NAR has affiliations with 54 state and territorial associations and more than 1,600 local associations. When one of these local associations owns and operates an MLS, this NAR-affiliated MLS is expected to follow NAR’s model guidelines for various operational and governance issues, such as membership requirements and rules for members’ access to and use of listing information. If a local association or its MLS fails to comply with these guidelines, it can lose important insurance coverage provided through NAR or have its charter membership in NAR revoked. An MLS that is not affiliated with NAR is not bound by these guidelines.

Individual states regulate real estate brokerage, establishing licensing and other requirements for brokers and agents. Of the two categories of state-licensed real estate practitioners, *brokers* generally manage their own offices, and *agents*, or salespeople, must work for licensed brokers. States generally require brokers to meet more educational requirements than agents, have more experience, or both. For the purposes of this report, we generally refer to all licensed real estate practitioners as brokers. Generally, a state commission, led by appointees who may have a professional background in real estate, oversees implementation of and compliance with state requirements and may respond to complaints about brokers or agents or take disciplinary action. Federal agencies do not play a day-to-day regulatory role in real estate brokerage, although DOJ and FTC enforce compliance with federal antitrust laws in this market, as they do for many other markets.

Banks may obtain charters at the federal or state level, and their activities are subject to oversight by federal or state regulators. The Office of the Comptroller of the Currency, which is a bureau within the Department of the Treasury (Treasury), charters and regulates national banks. State-chartered banks are overseen by state regulators and, if they have federal deposit insurance, a federal regulator.[6] Many companies that own or control banks are regulated by the Board of Governors of the Federal Reserve System (Federal Reserve) as bank holding companies. Under the 1999 Gramm-Leach-Bliley Act (Pub. L. No. 106-102), bank holding companies may qualify as financial holding companies and thereby engage in a range of financial activities broader than those traditionally permitted for bank holding companies, such as securities and insurance underwriting.

Some states permit state-chartered banks to engage in real estate brokerage, but national banks and financial holding companies may not engage in such activity. The Gramm-Leach-Bliley Act permits financial holding companies and financial subsidiaries of national banks to engage in activities that the Federal Reserve and the Treasury deem, through order or regulation, to be financial in nature, incidental to such financial activity, or both complementary to a financial activity and not posing substantial risk to the safety and soundness of depository institutions or the financial system generally. In late 2000, the Federal Reserve and the Treasury released a proposed regulation to allow banking companies to enter real estate brokerage under some circumstances.[7] However, from fiscal years 2003 to 2005, amendments to appropriations laws precluded the Federal Reserve and the Treasury from issuing such regulations. Legislation was introduced in the 109th Congress to prohibit financial holding companies and national banks from engaging in real estate brokerage activities. Legislation was also introduced to permit such activity.

Various Factors Can Influence the Extent of Price Competition in Real Estate Brokerage

A number of factors can influence the degree of price competition in the real estate brokerage industry. Some economists have observed that brokers typically compete more on nonprice factors, such as service quality, than on price. Evidence from academic literature and industry participants with whom we spoke highlighted several potential causes of this apparent lack of price competition. These potential causes include broker cooperation, largely through MLSs, which can discourage brokers

[6]The Board of Governors of the Federal Reserve System oversees state-chartered commercial banks that are members of that system. Other state-chartered banks with federal deposit insurance receive oversight from the Federal Deposit Insurance Corporation.

[7]Board of Governors of the Federal Reserve System and the Department of the Treasury, "Bank Holding Companies and Change in Bank Control," 66 Fed. Reg. 307 (Jan. 3, 2001).

from competing with one another on price; resistance from traditional full-service brokers to brokers who offer discounted prices or limited services; limited pressure from consumers for lower prices; and state antirebate and minimum service laws and regulations, which some argue may limit pricing and service options for consumers.

Real Estate Brokerage Is Characterized More by Nonprice Competition Than Price Competition

The real estate brokerage industry has a number of attributes that economists normally associate with active price competition. Most notably, the industry has a large number of brokerage firms and individual licensed brokers and agents—approximately 98,000 active firms and 1.9 million active brokers and agents in 2004, according to the Association of Real Estate License Law Officials.[8] Although some local markets are dominated by 1 or a few large firms, market share in most localities is divided among many small firms, according to industry analysts. In addition, the industry has no significant barriers to entry, since obtaining a license to engage in real estate brokerage is relatively easy and the capital requirements are relatively small.

While real estate brokerage has competitive attributes, with a large number of players competing for a limited number of home listings, much of the academic literature and some industry participants we interviewed described this competition as being based more on *nonprice* variables,

[8]The Association of Real Estate Law License Officials is a membership organization comprised of governmental agencies that regulate real estate activities and license brokers and agents. According to association officials, its members include regulators from 48 states as well as U.S. territories and other countries. The association compiles data on the number of real estate brokers, agents, and firms from state licensing agencies.

such as quality, reputation, or level of service, than on *price*.[9, 10] One reason for this characterization is the apparent uniformity of commission rates. Although comprehensive data on brokerage fees are lacking, past analyses and anecdotal information from industry analysts and participants indicate that, historically, commission rates have remained relatively uniform across markets and over time. Various studies using data from the late 1970s through the mid-1980s found evidence that the majority of listings in many communities clustered around the same rate, exactly 6 percent or 7 percent.[11] Although these studies and observations do not indicate that there has been complete uniformity in commission rates, they do suggest that variability has been limited.[12] Many of the industry analysts and participants we interviewed said that commissions still cluster around a

[9]For discussions of nonprice competition among brokers, see J.H. Crockett, "Competition and Efficiency in Transacting: The Case of Residential Real Estate Brokerage," *AREUEA Journal*, vol. 10, no. 2 (1982); D.R. Epley and W.E. Banks, "The Pricing of Real Estate Brokerage for Services Actually Offered," *Real Estate Issues*, vol. 10, no. 1 (1985); T.J. Miceli, "The Welfare Effects of Non-Price Competition Among Real Estate Brokers," *Journal of the American Real Estate and Urban Economics Association*, vol. 20, no. 4 (1992); and G.K. Turnbull, "Real Estate Brokers, Nonprice Competition and the Housing Market," *Real Estate Economics*, vol. 24, no. 3 (1996).

[10]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. However, we found that older research findings in this area have been consistent with more recent studies, as well as with testimonial evidence we obtained in interviews with industry analysts and market participants. For the most part, the economic literature and available data related to real estate commissions cover existing home sales and not new construction.

[11]For example, FTC found that more than one-half of home sales had a commission rate of 6 percent, and that from one-quarter to one-third had a commission rate of 7 percent. FTC based its findings on an analysis of closing documents from 7,622 sales made nationwide in 1977 and a national survey of 934 consumers who had sold homes in 1978 and 1979. FTC found similar clustering at 6 percent and 7 percent in closing documents from sales in 15 of 16 cities examined (Federal Trade Commission, *The Residential Real Estate Brokerage Industry*, vol. 1 (Washington, D.C.: 1983)). J.E. Larsen and W.J. Park, "Non-Uniform Percentage Brokerage Commissions and Real Estate Market Performance," *AREUEA Journal*, vol. 17, no. 4 (1989), found that about 90 percent of listings had a commission rate of 7 percent in their analysis of 669 listings in the Lincoln, Nebraska, area in 1986.

[12]Some researchers have attempted to identify and explain variations in commission rates. For example, using samples of commission rate data within specific geographic areas, some studies found that rates could vary with, among other things, a property's price or age, its expected "difficulty of sale" (e.g., whether the home was vacant or renter-occupied), or the size of the brokerage firm. See M. Carney, "Costs of Pricing of Home Brokerage Services," *AREUEA Journal*, vol. 10, no. 3 (1982); W.C. Goolsby and B.J. Childs, "Brokerage Firm Competition in Real Estate Commission Rates," *The Journal of Real Estate Research*, vol. 3, no. 2 (1988); and C.F. Sirmans and G.K. Turnbull, "Brokerage Pricing under Competition," *Journal of Urban Economics*, vol. 41, no. 1 (1997).

common rate within most markets, and they generally cited rates of 5 percent to 6 percent as typical now.

Some economists have cited certain advantages to the commission-based model that is common in real estate brokerage, most notably that it provides sellers' brokers with an incentive to get the seller the highest possible price.[13] Moreover, uniformity in commission rates within a market at a given time does not necessarily indicate a lack of price competition. But some economists have noted that in a competitive marketplace, real estate commission rates could reasonably be expected to vary across markets or over time—that is, to be more sensitive to housing market conditions than has been traditionally observed.[14] For example, commission rates within a market at a given time do not appear to vary significantly on the basis of the price of the home. Thus, the brokerage fee, in dollar terms, for selling a $300,000 home is typically about three times the fee for selling a $100,000 home, although the time or effort required to sell the two homes may not differ substantially.[15] Similarly, commission rates do not appear to have changed as much as might be expected in response to rapidly rising home prices in recent years. Between 1998 and 2003, the national median sales price of existing homes, as reported by NAR, increased 35 percent, while inflation over the same period was 10 percent, leaving an increase of some 25 percent in the inflation-adjusted price of housing. According to REAL Trends, average commission rates fell from an estimated 5.5 percent in 1998 to an estimated 5.1 percent in 2003, a

[13]For example, see M.A. Arnold, "The Principal-Agent Relationship in Real Estate Brokerage Services," *Journal of the American Real Estate and Urban Economics Association*, vol. 20, no. 1 (1992); and G.D. Jud and J. Frew, "Real Estate Brokers, Housing Prices, and the Demand for Housing," *Urban Studies*, vol. 23, no. 1 (1986).

[14]For example, see P. Anglin and R. Arnott, "Are Brokers' Commission Rates on Home Sales Too High? A Conceptual Analysis," *Real Estate Economics*, vol. 27, no. 4 (1999); R. Bartlett, "Property Rights and the Pricing of Real Estate Brokerage," *The Journal of Industrial Economics*, vol. 30, no. 1 (1981); and C. Hsieh and E. Moretti, "Can Free Entry Be Inefficient? Fixed Commissions and Social Waste in the Real Estate Industry," *The Journal of Political Economy*, vol. 111, no. 5 (2003).

[15]Some industry participants we met with suggested that it costs more to market expensive homes, in part because the number of prospective buyers is smaller. However, we did not identify any data on brokers' actual costs of marketing homes.

decrease of about 7 percent.[16] Thus, with the increase in housing prices, the brokerage fee for selling a median-priced home increased even as the commission rate fell.[17]

Some economists have suggested that uniformity in commission rates can lead brokers to compete on factors other than price in order to gain market share. For example, brokers might hire more agents in an effort to win more sellers' listings.[18] Brokers may also compete by spending more on advertising or offering higher levels of service to attract clients.[19] Although some of these activities can benefit consumers, some economic literature suggest that such actions lead to inefficiency because brokerage services could be provided by fewer agents or at a lower cost.[20] For example, although advertising can be effective in providing buyers and sellers with information about broker services, the consumer benefit from brokers' expenditures on advertising or promotions aimed at acquiring listings may be less than their cost to the broker.

[16]REAL Trends' data do not address the range of or variation among actual commission rates. REAL Trends' estimates average commission rates by dividing the total gross commission revenue reported by the largest brokerage firms by their total sales volume. The estimate for 1998 was based on data from 532 firms, and the estimate for 2003 was based on data from 541 firms. We considered REAL Trends' estimates to be sufficiently reliable on the basis of the competency of the source producing the estimates and the reasonableness of the estimates.

[17]Similarly, a decrease in commission rates from the prevalent 6 percent and 7 percent rates reported by FTC in the period around 1980 to the levels reported by REAL Trends in recent years would have been more than offset by appreciation in housing prices during that period.

[18]For example, see Crockett, "Competition and Efficiency in Transacting." Because agents generally are hired as independent contractors whose incomes are based on commissions for complete sales, brokers can hire agents to compete for more listings without incurring significant up-front costs for their labor.

[19]For example, see Miceli, "The Welfare Effects of Non-Price Competition," and Turnbull, "Real Estate Brokers, Nonprice Competition and the Housing Market."

[20]For example, see Hsieh and Moretti, "Can Free Entry Be Inefficient?"; Miceli, "The Welfare Effects of Nonprice Competition"; and Crockett, "Competition and Efficiency in Transacting."

To the extent that commission rates may have declined slightly in recent years, the change may be the result in part of rapidly rising home prices, which have generated higher brokerage industry revenues even with lower commission rates. However, competition from increasing numbers of discount, fee-for-service, and other nontraditional brokerage models may have also contributed to the decline. These nontraditional models typically offer lower fees, and although they currently represent only about 2 percent of the market, they may be putting some downward pressure on the fees charged by traditional brokerages.[21]

Certain Factors May Inhibit Price Competition within the Real Estate Brokerage Industry

Factors related to the cooperation among brokers facilitated by MLSs, some brokers' resistance to discounters, and consumer attitudes may inhibit price competition within the real estate brokerage industry.[22]

Cooperation Facilitated by Multiple Listing Services

While MLSs provide important benefits to consumers by aggregating data on homes for sale and facilitating brokers' efforts to bring buyers and sellers together, the cooperative nature of the MLS system can also in effect discourage brokers from competing with one another on price. Because participating in an MLS in the areas where they exist is widely considered essential to doing business, brokerage firms may have an incentive to adopt practices that comply with MLS policies and customs. As previously noted, MLSs facilitate cooperation in part by enabling brokers to share information on the portion of the commission that sellers' brokers are offering to buyers' brokers. In the past, some MLSs required participating brokers to charge standard commission rates, but this practice ended after the Supreme Court ruled, in 1950, that an agreement to fix minimum prices was illegal under federal antitrust laws.[23] Subsequently, some MLSs adopted suggested fee schedules, but this too ended after DOJ brought a series of antitrust actions in the 1970s alleging that this practice constituted

[21]Consultants to NAR estimated that discount, full-service brokerages, Internet-oriented full-service brokerages, broker referral services, and other nontraditional brokerage models collectively represented buyers and sellers in less than 2 percent of all real estate brokerage transactions in 2003.

[22]We make no judgment on the legality of any actions that may inhibit price competition; such matters are beyond the scope of our work.

[23]*United States v. National Association of Real Estate Boards*, 339 U.S. 485, 488-89 (1950).

price fixing.[24] Today, MLSs no longer establish standard commission rates or recommend how commissions should be divided among brokers. MLS listings do show how much sellers' brokers will pay other brokers for cooperating in a sale, according to industry participants. When choosing among comparable homes for sale, brokers have a greater incentive—all else being equal—to first show prospective buyers homes that offer other brokers the prevailing commission rate than homes that offer a lower rate. Therefore, even without formal policies to maintain uniform rates, individual brokers' reliance on the cooperation of other brokers to bring buyers to listed properties may help maintain a standard commission rate within a local area, at least for buyers' brokers.[25]

Traditional Brokers' Resistance to Nontraditional Brokerage Models

Traditional brokers may discourage price competition by resisting cooperation with brokers and firms whose business models depart from charging conventional commission rates, according to several industry analysts and participants we spoke with. A discount broker may advertise a lower commission rate to attract listings, but the broker's success in selling those homes, and in attracting additional listings in the future, depends in part on other brokers' willingness to cooperate (by showing the homes to prospective buyers) in the sale of those listings. Some discount full-service and discount limited-service brokerage firms we interviewed said that other brokers had refused to show homes listed by discounters.[26] In addition, traditional brokers may in effect discourage discount brokers from cooperating in the sale of their listings by offering discounters a lower buyer's broker commission than the prevailing rate offered to other

[24]For example, see *United States v. Greater Pittsburgh Bd. of Realtors*, 1973-1 Trade Cas. ¶ 74,454 (W.D. Pa. 1973) and *United States v. Los Angeles Realty Bd.*, 1973-1 Trade Cas. ¶ 74,366 (C.D. Cal. 1973). In 1971, NAR adopted a policy prohibiting its affiliated MLSs from fixing or recommending to their members commission rates or fees to be charged or the percentage division of commissions or fees.

[25]For examples of this long-standing observation, see Bartlett, "Property Rights and the Pricing of Real Estate Brokerage"; Crockett, "Competition and Efficiency in Transacting"; T.J. Miceli, "The Multiple Listing Service, Commission Splits, and Broker Effort," *AREUEA Journal*, vol. 19, no. 4 (1991); and N.G. Miller and P.J. Shedd, "Do Antitrust Laws Apply to the Real Estate Brokerage Industry?," *American Business Law Journal*, vol. 17, no. 3 (1979). FTC (*Residential Real Estate Brokerage*) concluded that the cooperative nature of the industry and the interdependence among brokers were the most important factors explaining the general uniformity in commission rates that it had observed in many markets in the late 1970s.

[26]We did not investigate specific instances of brokers' alleged refusal to show homes listed with discounters, nor do we have information to assess how common such a practice might be.

brokers.[27] This practice can make it more difficult for discount brokers to recruit new agents because they may earn more working for a broker who receives the prevailing commission from other brokers.[28] Some traditional full-service brokers have argued that discount brokers often do less of the work required to complete the transaction and, thus, deserve a smaller portion of the seller's commission. Representatives of discount brokerages told us they believed that reduced commission offers are in effect "punishment" for offering discounts to sellers and are intended as signals to other brokers to conform to the typical pricing in their markets.

Limited Consumer Pressure

Pressure from consumers for lower brokerage fees appears to be limited, although it may be increasing, according to our review of economics literature and to several industry analysts and participants. Consumers may accept a commission rate of about 6 percent as an expected cost of selling a home, in part because that has been the accepted pricing model for so long, and some consumers may not know that rates can be negotiated. Buyers may also have little concern about commission rates because sellers directly pay the commissions. Sellers may be reluctant to reduce the portion of the commission offered to buyers' brokers because doing so can reduce the likelihood that their home will be shown.[29] In addition, home sellers who have earned large profits as housing prices have climbed in recent years may have been less sensitive to the price of brokerage fees. However, some brokers and industry analysts noted that the growth of firms offering lower commissions or flat fees has made an increasing

[27]We did not investigate alleged incidents of differences in the commissions offered to buyers' brokers. We note that the practice of offering certain firms a smaller share of the commission than that posted in the MLS is not necessarily limited to firms that advertise discounted prices. In a private antitrust suit settled in 2000, Re/Max International, Inc., and some of its franchises alleged that two large brokerage firms in northeast Ohio had conspired to prevent Re/Max from establishing a presence in that area by offering Re/Max agents less in commission than other agents. *Re/Max International, Inc., v. Realty One, Inc.*, 173 F.3d 995 (6th Cir. 1999). Re/Max does not advertise itself as a brand that offers discounted fees, but its business model departs from the traditional brokerage model in which brokers retain a significant portion of agents' commissions. Re/Max agents retain 95 percent to 100 percent of their commission revenues and pay a fixed monthly fee to their brokers, an approach that arguably gives agents greater flexibility to reduce their fees than the traditional brokerage model.

[28]Conversely, officials from one firm suggested that a broker that offers lower commissions to other brokers may have difficulty recruiting or retaining agents because the affected brokers will have less incentive to cooperate with those agents.

[29]Anglin and Arnott, "Are Brokers' Commission Rates on Home Sales Too High?," and Goolsby and Childs, "Brokerage Firm Competition in Real Estate Commission Rates."

number of consumers aware that there are alternatives to traditional pricing structures and that commission rates are negotiable.

Some State Laws and Regulations Can Affect Price Competition

Although state laws and regulations related to real estate licensing can protect consumers, DOJ and FTC have expressed concerns that some of these laws and regulations may also unnecessarily hinder competition among brokers and limit consumer choice.

Antirebate Provisions

At least 14 states appear to prohibit, by law or regulation, real estate brokers from giving consumers rebates on commissions or to place restrictions on this practice.[30] Proponents say such laws and regulations help ensure that consumers choose brokers on the basis of the quality of service as well as price, rather than just on the rebate being offered.[31] Opponents of antirebate provisions argue that such restrictions serve only to limit choices for consumers and to discourage price competition by preventing brokers from offering discounts.[32] Proponents also note that offering a rebate is one of the few ways to reduce the effective price of buyer brokerage services since commissions are typically paid wholly by the seller.[33] In March 2005, DOJ's Antitrust Division filed suit against the Kentucky Real Estate Commission, arguing that the commission's administrative regulation banning rebates violated federal antitrust laws. In

[30]Based on our review of selected statutes and regulations in states identified by the Association of Real Estate Law Licensing Officials and two brokerage firms that provide rebates to consumers, states that appear to prohibit or place restrictions on real estate brokers giving consumers rebates on commissions include Alabama, Alaska, Iowa, Kansas, Kentucky, Louisiana, Mississippi, Missouri, New Hampshire, New Jersey, Oklahoma, Oregon, Tennessee, and West Virginia. We did not review all states' laws and regulations or evaluate how the states interpret and apply provisions, so other states may also prohibit or restrict commission rebates to consumers. The original intent of some state antirebate laws and regulations was to avoid conflicts of interest between agents and customers by preventing brokers from giving a share of their commission to lawyers, title companies, or others involved in the real estate transaction.

[31]*Coldwell Banker Residential Real Estate Servs. v. Clayton*, 475 N.E.2d 536, 543 (Ill. 1985).

[32]During negotiations for the sale of a home, brokers sometimes agree to reduce their commissions to pay for repairs or to bridge a gap between the offer and the asking price. However, these reductions do not represent price competition because they are offered after the buyer and seller have selected their brokers.

[33]According to economic theory, sellers pass a portion of their brokerage costs to buyers in the price of the home. By offering a rebate to the buyer, a broker is in effect offering to offset this cost.

its complaint, DOJ argued that the regulation unreasonably restrained competition to the detriment of consumers, making it more difficult for them to obtain lower prices for brokerage services.[34] In July 2005, DOJ and the commission proposed a settlement agreement which, if approved by the court, would require the commission to cease enforcing its regulation prohibiting rebates and other inducements.[35]

Minimum Service Standards

Ten states are considering or have passed legislation that requires brokers to provide a minimum level of service when they represent consumers.[36] Such provisions generally require that when a broker agrees to act as a consumer's exclusive representative in a real estate transaction, the broker must provide such services as assistance in delivering and assessing offers and counteroffers, negotiating contracts, and answering questions related to the purchase and sale process. Advocates of minimum service standards argue that they protect consumers by ensuring that brokers provide a basic level of assistance. Further, full-service brokers argue that such standards prevent them from having to unfairly shoulder additional work when the other party uses a limited-service broker. Opponents of these standards argue that they restrict consumer choice and raise costs by impeding brokerage models that offer limited services for a lower price.[37] In April and May 2005, DOJ wrote to state officials in Oklahoma, and DOJ and FTC jointly wrote to officials in Alabama, Missouri, and Texas, discouraging adoption of these states' proposed minimum service laws and regulations. The letters argued that the proposed standards in these states would likely harm consumers by preventing brokers from offering certain limited-service options and therefore requiring some sellers to buy brokerage services they would otherwise choose to perform themselves. They also

[34]Complaint, United States v. Kentucky Real Estate Commission, U.S. Dist. Ct., W.D. Ky., Case No. 3:05CV-188H, at 1, 2 (Mar. 30, 2005).

[35]Department of Justice, Antitrust Division, "United States v. Kentucky Real Estate Commission; Proposed Amendment Final Judgment and Competitive Impact Statement," 70 Fed. Reg. 45,424 (Aug. 5, 2005).

[36]As of August 16, 2005, Alabama, Florida, Illinois, Iowa, Missouri, Oklahoma, Texas, and Utah had enacted minimum service standards. Delaware and Kansas were considering adopting such standards.

[37]Minimum service standards would not necessarily prohibit a broker from providing limited advice or service to a client if the broker had not agreed to act as the consumer's exclusive representative. However, an MLS may require brokers to have such an agreement in order to enter a property listing in the MLS.

cited a lack of evidence that consumers have been harmed by limited-service brokerage. Despite the concerns raised by DOJ and FTC, the governors in all 4 states subsequently signed minimum service standards into law.

Similarly, while state licensing rules for real estate brokers and agents may ensure standards of quality that protect consumers, these rules may also restrict consumers' ability to choose among services and prices, ultimately reducing competition. For example, in 2004, a federal district court found unconstitutional a California real estate licensing law that required the operator of a for-sale-by-owner Web site to obtain a brokerage license in order to advertise property listings without providing any additional brokerage services. The court found that the law impermissibly differentiated between publications displaying the same basic content on their Web sites, noting that newspapers were not required under the law to obtain a brokerage license simply to display property listings on their Web sites.[38]

The Internet Has Increased Consumers' Options, but Several Factors Could Limit Its Wider Use

The Internet has increased consumers' access to information about properties for sale and has facilitated new approaches to real estate transactions. Many brokers post information on their Web sites—in varying degrees of detail—on properties they have contracted to sell, enabling consumers to obtain such information without consulting a broker. The Internet also has fostered the creation or expansion of a number of Internet-oriented firms that provide real estate brokerage or related services, including discount brokers and broker referral services. Whether the Internet will be more widely used in real estate brokerage depends in part on the extent to which listing information is widely available. Like discount brokerages, Internet-oriented brokerage firms, especially those offering discounts, may also face resistance from traditional brokers and may especially be affected by state laws that prohibit them from offering rebates to consumers. In addition, certain factors—such as the lack of a uniform sales contract—may inhibit the use of the Internet for accomplishing the full range of activities needed for real estate transactions.

[38] *ForSaleByOwner.com Corp. v. Zinneman*, 347 F. Supp. 2d 868, 877 (E.D. Cal. 2004).

The Internet Allows Consumers More Direct Access to Information

The Internet allows consumers direct access to listing information that has traditionally been available only from brokers. Before the Internet was widely used to advertise and display property listings, MLS data (which comprise a vast majority of all listings) were compiled in an "MLS book" that contained information on the properties listed for sale with MLS-member brokers in a given area. In order to view the listings, buyers generally had to use a broker, who provided copies of listings that met the buyer's requirements via hard copy or fax. Today, information on properties for sale—either listed on an MLS or independently, such as for-sale-by-owner properties—is routinely posted on Web sites, often with multiple photographs or virtual tours. For example, NAR's Realtor.com Web site features more than 2 million properties listed with MLSs around the country, and most brokers also maintain their own Web sites with information on properties for sale in their area. Buyers may also search for non-MLS listed properties on the Web sites of companies that help owners market their properties themselves. Thus, the Internet has allowed buyers to perform much of the search and evaluation process independently, before contacting a broker.[39]

Sellers of properties can also benefit from the Internet because it can give their listings more exposure to buyers. For example, according to NAR, Realtor.com—which provides information on approximately 95 percent of all homes listed with MLSs around the country—had 6.2 million unique visitors in February 2005. Sellers who choose to sell their homes without the assistance of a broker can advertise their properties on a multitude of "for-sale-by-owner" Web sites. Sellers may also use the Internet to research suitable asking prices for their homes by comparing the attributes of their houses with others listed in their area.

[39]Before the Internet, a buyer could still learn about properties without a broker—for example, through newspaper advertisements or by driving past a property to view it. However, the Internet can provide consumers with far more extensive information, including, in some cases, complete details on the property from the MLS as well as photographs or a virtual tour.

Despite more active participation of some buyers and sellers in the transaction process, some industry analysts and participants noted that because of the complexity of real estate transactions, some buyers and sellers will always desire the assistance of a broker to help them navigate the process.[40] Unlike transactions that can now be completed entirely on the Internet—such as purchasing airline tickets or trading securities—real estate transactions are likely to continue to involve at least some in-person services for the foreseeable future.

The Internet Facilitates Alternative Service and Pricing Options

Although Internet-oriented brokerages and related firms represent only a small portion of the real estate brokerage market at present, the Internet has made different service and pricing options more widely available to consumers. Among these options are full-service and limited-service discount brokerages, information and referral companies, and alternative listing Web sites.

- *Full-service discount brokerages* offer buyers and sellers full-service real estate brokerage services—including listing properties in the MLS, conducting open houses, negotiating contracts, and assisting with closings—but advertise lower than traditional commissions, for example between 3 percent and 4.5 percent. These types of brokerages existed before widespread use of the Internet, but many have gained exposure and become more viable as a result of the Internet. In addition, by posting listings online, displaying photographs and virtual tours of homes for sale, and communicating with buyers and sellers by e-mail, some of these companies say that they have been able to cut brokerage costs, allowing them to offer rebates to buyers or discounted commissions to sellers.

- *Limited-service discount brokerages* provide fewer services than full-service brokerages but also offer lower commission rates or offer their services for flat fees. For example, some firms market a full array of brokerage services for a reduced commission but do not list homes in the MLS. Other firms charge a flat fee for marketing and advertising homes and, for additional fees, will list a property in the MLS and show the home to prospective buyers. Although these types of discount

[40]Consistent with Internet usage patterns in the United States, younger consumers may be more likely than older consumers to search listings online, a factor that could influence the growth of Internet use in real estate transactions over time.

brokers have existed since at least the 1970s, industry participants told us that the Internet has allowed them to grow in number and size in recent years, in part because they can market their services to a larger population of buyers and sellers.

- *Information and referral companies*, including some that are licensed real estate brokers, provide resources for buyers and sellers—such as home valuation tools and access to property listings—and make referrals of those consumers to local brokers.[41] Some of these companies charge referral fees to brokers and then rebate a portion of that fee back to buyers and sellers. It is through the Internet that these companies are able to efficiently reach potential consumers and offer those customers services and access to brokers.

- *Alternative listing Web sites* offer alternatives to the MLS, allowing sellers who want to sell their homes themselves to advertise their properties to buyers and giving buyers another source of information on homes for sale. These alternative listing sites include the Web sites of local newspapers, Craig's List, and "for-sale-by-owner" Web sites.[42] These services, which generally do not provide buyers and sellers with the assistance of a licensed broker, are limited to providing consumers with a venue for advertising homes and viewing properties for sale.

Wider Use of the Internet in Real Estate Brokerage Will Depend on the Availability of Listing Information and Other Factors

Several factors could limit the extent to which the Internet is used in real estate transactions. A key factor is the extent to which information about properties listed in an MLS is widely available. Currently, buyers may view MLS-listed properties on many Web sites, including broker and MLS Web sites and on Realtor.com. NAR has considered a policy on Virtual Office Web sites (VOW) that would allow brokers to selectively exclude their MLS listings from being displayed on certain other brokers' Web sites and would prohibit certain types of companies, such as information and referral

[41]These information and referral companies typically have a network of participating real estate brokers in various markets to which they refer customers. Although many information and referral companies are themselves licensed real estate brokers, they generally do not directly provide services typical of a real estate broker, such as showing homes or negotiating a sales price.

[42]Craig's List is a noncommercial Internet bulletin board that operates in 170 communities in 34 countries. Among other things, users of Craig's List can post or review information on properties for sale.

companies, from operating VOWs.[43] Proponents of this policy argue that listings are the work product, and thus the property, of the selling broker, who should have control over how the listings are used. Proponents maintain that brokers should be able to prevent certain companies—such as information and referral companies—from using their listings simply to earn referral fees. NAR and others have also argued that freely posting MLS data—such as addresses, descriptions of properties, and property tax information—on the Internet may compromise the security and privacy of their clients.

Opponents of the VOW policy argue that it is anticompetitive because it would unfairly limit Internet-oriented brokers' ability to provide their clients with access to MLS listings through their Web sites. They argue that NAR already has policies on the appropriate distribution of MLS information, and that their rules should treat information disseminated via the Internet no differently than information distributed via traditional bricks-and-mortar brokerages. They also note that measures can be taken to address security and privacy concerns related to MLS listings on the Internet, such as restricting the number of listings that result from an online search. Some opponents also expressed concern that some Internet-oriented brokers would not be able to compete if—in a market dominated by a single player—they were selectively excluded from displaying that player's listings.

Even with few restrictions on the availability of information about properties for sale, Internet-oriented brokerage firms may face other challenges. First, Internet-oriented brokers we spoke with described resistance, similar to that previously described, involving some traditional brokerages that refused to show the Internet-oriented brokerages' listed properties or offered them buyers' brokers commissions that were less than those offered to other brokers. However, the online availability of listing information may discourage such behavior by enabling buyers to more easily detect whether a broker is avoiding other brokers' listings that are of interest. Second, some Internet-oriented companies said that state antirebate laws and regulations could affect them disproportionately, since their model often was built around such rebates.

[43]NAR issued its VOW policy in 2003; however, NAR has postponed requiring implementation of the VOW policy by its affiliated MLSs pending the outcome of its negotiations with DOJ, whose Antitrust Division has been investigating the policy. According to NAR, some MLSs have implemented their own VOW policies.

Finally, certain factors may inhibit the use of the Internet for accomplishing the full range of activities needed for real estate transactions. For example, some companies told us that they would like to make greater use of the Internet to facilitate the execution of the contract used in the purchase and sale of a property. However, they said that there is no single, uniform sales contract for residential real estate, and state laws vary with respect to which disclosures must accompany a sales contract. They also said that state laws vary in their requirements for physical copies of signed contracts, attorneys' involvement in signing a contract, and the circumstances under which a contract may be rescinded. As a result, it would be difficult to develop an online platform that could be used nationwide for residential real estate contracts. Further, industry participants told us that no uniform technology currently exists to facilitate the assistance that brokers often provide in other aspects of the real estate transaction, such as coordinating inspections, appraisals, financing, title searches, and settlements.

Few State-Chartered Banks Appear to Engage in Real Estate Brokerage

Our review of certain state statutes and regulations showed that approximately 30 states may potentially authorize state-chartered banks or their operating subsidiaries to engage in some real estate brokerage activities. However, we also found that because only a small number of banks in these states appeared to have taken advantage of this authority, the effect on competition and consumers was likely minimal. We reviewed the state statutes and regulations that NAR and the Conference of State Bank Supervisors, using the broadest interpretations, identified as potentially authorizing banks' brokerage activity. While many of these laws are ambiguous and subject to interpretation by state regulators, it appears that at least 5 states and the District of Columbia provide relatively clear authority for banks or their subsidiaries to engage in real estate brokerage. An additional 8 states permit involvement in other real-estate-related activities or in unspecified activities that might be approved by the state. At least 7 states could potentially permit banks to conduct real estate activities as an incidental power, an activity closely related to banking, or an activity that is financial in nature. Many of the remaining states could potentially allow state-chartered banks to conduct real estate activities to the extent that national banks or other federal depository institutions are allowed to do so.

The exact number of state-chartered banks that engage in real estate brokerage is unknown because not all state regulators track such activity. However, available data and interviews with real estate, banking, and state regulatory officials suggest that such activity is very limited among the approximately 5,700 state-chartered banks nationwide. In separate surveys in 2001, NAR and the Conference of State Bank Supervisors identified only eight states where state-chartered banks had engaged in at least some real estate brokerage activity. More recent data were not available, but regulators and industry officials told us that they doubted that this activity had expanded significantly since 2001. They noted that real estate brokerage is not typically part of a bank's business model, and that banks in small communities may be reluctant to compete with local real estate brokers that may be clients of the banks.

We spoke with officials from banks engaged in real estate brokerage, bank regulators, and real estate industry representatives in Iowa and Wisconsin—two states identified as having the most banks involved in real estate brokerage in 2001.[44] The seven such banks we identified in these states were all in small communities that had few or no other real estate brokers, and some of these banks noted that their presence provided an additional option for local residents. None of the banks we spoke with offered brokerage services that were different than those offered by traditional brokerages, and none offered discount brokerage services. Most of the bank officials said that real estate brokerage was not a large portion of their business. They said their primary goal was not to link brokerage customers to the bank's mortgage financing and added that most of their brokerage customers in fact obtained their mortgages outside of the bank.

As agreed with your offices, unless you publicly announce its contents earlier, we plan no further distribution of this report until 30 days from the report date. At that time, we will send copies to the Secretary of Housing and Urban Development, the Attorney General, and the Chairman of the Federal Trade Commission. We will make copies available to others upon request. This report will also be available at no charge on GAO's Web site at http://www.gao.gov.

[44] The information we obtained from these banks is meant to be illustrative and is not representative of all banks' brokerage activity nationwide.

Please contact me at (202) 512-8678 or woodd@gao.gov if you or your staffs have any questions about this report. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. Key contributors to this report are listed in appendix I.

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