

The myth of the buyer's broker

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Let's start here: in the U.S. real estate market, there's no such thing as a buying agent. The REALTOR[®] that show you the house and arranges your papers will likely tell you that you're not paying them—so who is, and why does your agent have any incentive to aggressively advocate for you?

In fact, we have to start further back. To sell a house in any state in the Union, you have to be licensed by the state as a real estate agent. Also, there is a private organization, the National Association of Realtors (NAR), to which the great majority of agents are a member. The NAR imposes additional rules, and grants insider privileges to members. The most notable is access to a *mutual listing service*, which is the *de facto* list of all houses/condos/refrigerator boxes for sale in an area. There are competing lists, but the NAR-affiliated MLSes have been around for decades, and are still the go-to list in most (but not quite all) markets.

NAR members agree to a code of ethics¹, which boils down to promising not to do anything illegal, and to arbitrate many categories of dispute that would otherwise go before a court. The thing that most strikes me about the code of ethics is that things like “REALTORS[®], in attempting to secure a listing, shall not deliberately mislead the owner as to market value” acutally have to be stated at all. Most of the clauses seem like common sense, and are vague to the point of unenforceability. I'm despondent that I missed the house I wanted because a REALTOR[®] failed to live up to Standard of Practice 1-6: “REALTORS[®] shall submit offers and counter-offers objectively and as quickly as possible.” But how can I prove that a three-day delay is not “as quickly as possible”?

It's unenforceable, and in every other industry the sort of things specified here are just given. ‘Waiters shall make an effort to quickly fulfill diner requests.’ Sounds tautological and not exactly the stuff of ethics, no? But it turns out that there's a reason rooted in contract law why REALTORS[®] need this sort of thing while other industries don't.

Anyway, an *agent* is anybody with a state-issued real estate license; REALTOR[®] (yes, the NAR really does use all caps in all uses of the word) is a trademarked term referring to a member of the NAR.

The trickiest clause When you sell a house, you may go to a REALTOR[®], and sign a contract to sell. The contract will include an elaborate payment clause, which is

¹<http://www.realtor.org/mempolweb.nsf/pages/code>

unique in the world of legal contracts. Here's how it goes:

- The broker gets a commission, usually six percent.
- If another REALTOR[®] is the *procuring cause* in getting a buyer to purchase the house, then that other REALTOR[®] is called the *cooperating broker* and will be given an advertised sub-commission taken from that six percent; it's usually half of the six percent, i.e. 3%, or sometimes maybe 2%.
- If no other REALTOR[®] is the procuring cause, then the selling agents keeps the full 6%. This is often explicitly stated as a *safety clause*.

Here's another way to think about it: there are no individual agents. When you sell a house, you contract with the NAR to arrange the sale. The buyer solicits the NAR to buy the house, and the NAR makes the deal happen.

The metaphor they want you to think of is the open-air stock market, where one agent calls out that he has a house to sell, and another independent agent wanders by and says that she needs a house, and they haggle. The better metaphor is the department store. Vendors put their items on display, often paying the store to do so, and then salesfolk wander around, make you feel good, and assist you in finding the item that will score them the largest commission. The commissioned salesperson has every incentive to be helpful and every incentive to make certain that you walk out of the store with something.

Some salespeople are really nice. Their primary interest is in helping you find the things that will work best for you, and are aware that doing a good job in that will lead to happier customers buying more stuff, and therefore higher commissions. Some salesfolk cut out the tedium of helping the customer and just go straight to talking the customer into buying the most expensive item.

With a contract clause that all agents are technically paid by the seller, the buyer can enlist the assistance of an agent, but is unable to pay that agent, and therefore has no means of providing incentive to the agent to represent his or her interests. Notably, if the agent can get you to blow an extra \$50k on a house, then that's another \$1,500 for the agent, which is not a small incentive. Some agents have a strong moral compass and easily resist these temptations. But the joy of a contract where the buyer pays the agent for performance (not a bigger house) is that the agent can be one of the slimebag salespeople, but still has no incentive to screw the buyer.

By contrast, in the open market approach, the buyer hires an agent, pays that person directly, and if the agent fails to represent the buyer's interests, the buyer gets another. But when the norm is the procuring cause setup, it's hard to break in as a buying agent who works directly for the buyer.

[There exist people who refer to themselves as *buyer's agents*. They are members of the NAR who do not do any sales contracts, and therefore assure the buyer that there is much less conflict of interest, and they are more clearly focused on buyer incentives. But from what searching I did on the subject, all are still paid out of the seller's payments, and so there are still barriers to negotiating an alternate price, and still no incentives to get the buying agent to be aggressive in haggling down closing costs and such.]

[And while I'm digressing, the procuring cause issue causes lots of conflict even among REALTORS[®], because causation is fundamentally unmeasurable. Notably, there is invariably multiple causation, such as

one agent who pointed out the listing, one who showed the house, and one who printed out the contract. Each was a contributing cause of the sale, but payment is made to only one—it'd just be way too messy to split, I suppose. Also, allowing a split opens the door for several partial-service brokers to work together. Endless conflicts as to who provided the most partial causation ensues.]

In 2006, the FTC charged a number of REALTOR[®]-owned listing sites with anti-competitive practices locking in the shop-with-salespeople model of commission payment. From the must-read workshop report²:

The rules or policies challenged in the complaints state that information about homes is not allowed to be made available on popular real estate websites unless the listing contracts are exclusive right to sell listings (i.e., that require compensation no matter how the home is sold). When implemented by each of the respondents, this “Web Site Policy” prevented homes with [...] non-traditional listing contracts from being displayed on a broad range of public real estate websites, including Realtor.com. [FTC/DOJ report, PDF/print version p 63]

If you want to be a buyer's agent, then you've got to start over. One way of doing this is for the cooperating agent to take the 3% commission, rebate all of it to the buyer, then negotiate new terms for payment from the buyer. This is actually illegal in ten states, as this hilarious Department of Justice page³ explains. The page exists because the DoJ can't change state laws that blatantly encourage anti-competitive distortions in the marketplace, but can at least put up pages taunting the states.

Where do those laws come from, given that the DoJ had such trouble finding somebody to defend them? It's a mystery why there are laws propping up the traditional NAR model. Is this tally by opensecrets.org⁴ that found the NAR to be the #3 top all-time political campaign donor, 1989-2010, a clue? Who knows.

What if you want to not use an agent at all? No problem, but you'll be handing 3% to the selling REALTOR[®]—the shop keeps all the cash if there's no salesperson to commission. So buying without an agent is folly, simply because the system is set up that way. But do you really need a buying broker?

There once was a time when having a REALTOR[®] was essential, because they had the listings. Pre-Internet, a city would have exactly one repository of listing information, and that would be the mutual listing service of the various brokerages. Post-Internet, this sort of central database is the sort of thing a couple of Caltech undergrads would put together in their spare time. So REALTORS[®] now lack the informational advantage they used to have. What else do they do? They refer you to a home inspector, because few are truly competent to inspect a house's physical condition. [And remember: never use the home inspector recommended by an agent, because the deck is so stacked toward recommending inspectors who won't cause the contract to fall through.] They refer you to a real estate lawyer to do the paperwork, because few REALTORS[®] are competent to do the absolutely arcane and detailed paperwork. They offer advice, which many are very much competent to do. They negotiate a price, except if you're a buyer they have no incentive to

²<http://www.justice.gov/atr/public/reports/223094.htm>

³http://www.justice.gov/atr/public/real_estate/rebates.htm

⁴<http://www.opensecrets.org/orgs/list.php>

negotiate for you, and there's anecdotal evidence all over the Web of agents who relay information that should be kept on the buyer's side of the table directly to the seller.

It makes sense to have an agent and not just do it all yourself. There's a lot that can go wrong, and they have more experience than you by a long shot. But given how little of the process really requires an agent, you might want a partial-service agent who provides some kibbitzing but not the full shebang. That's where the anti-trust questions come up again.

Most agents are on both sides of the market every day, which makes possible retaliation for being nice to buyers. Discount brokers, who typically offered partial service for less than the NAR-standard six percent and/or offered buyer rebates, filed complaints with the FTC/DOJ that other agents wouldn't show their homes to potential buyers: "I have had agents tell me personally they have been instructed by their broker not to show our properties." [p 69] So anecdotally, we have what can only be called collusive price fixing. The DOJ didn't have enough evidence to really prosecute, though, and because the DoJ did set rules in other actions that online listings may not be filtered, steering is more difficult now.

Better still, many states have laws actually outlawing partial-service brokers. If you want to be an agent in those states, you can't provide consulting services or contract negotiations but omit driving-the-client-around services for an appropriately lower price. The FTC/DOJ report is especially fun on this point [p 49] because absolutely nobody could explain why these laws are on the books, and nobody wanted to mention that, as above, the Center for Responsive Politics found that the NAR was outspent in its lobbying efforts only by AT&T and AFSCME (a gov't employees' union).

Commissions have remained fixed, drifting from around 6% in 1991 to around 5% in the present day. But that's in a period when housing prices in some markets have exploded, meaning that, during the period from 2001 to 2005 (when the FTC/DoJ put out their study) agent commissions were rising 5% or more per year—just as the 'Net was reducing the agent's informational products from exceptional to just another query.

So, the story so far: real estate sales contracts include an eccentric clause that both buying and selling agents are to be paid from the seller's account. This means that the buyer has difficulty negotiating prices for services they receive, and have no real representation at negotiations. Commissions all around have been relatively fixed at 6%, partly because the eccentric clause makes for eccentric price negotiations, and there's lots of evidence of anti-competitive behavior by the NAR and its members. Switching to an open market setup where buyers pay to have buyer representation will be difficult, because the safety clause may mean that if you get a personal buyer, their fee will be on top of the 3% you just uselessly rescinded to the listing agent.

Effects OK, so prices are now too high: agents are paid a percentage of a fast-rising price for less work, given that the Internet does the information aggregation for them. [As a side-rant, the Internet does it better: the mutual listing services I've worked with don't give square footage of properties, though non-NAR services easily find it from property records. I mean, isn't size of the house sorta a basic piece of information? Instead, the MLSes I've seen just give you number of bedrooms as a proxy for size, which leads to those pathetic rooms split in half to turn a 2br into a 3br.]

Because prices are stuck too high, there are "too many" real estate agents. On the

supply side, there aren't really many things keeping somebody from being an agent. To get a license, you need training, but we're not talkin' three years of law school. Courses are typically a few weeks at most. On the *perceived* demand side, the housing bubble meant dollar signs to a lot of folks who were fine with taking a few weeks of training: you sell one million-dollar home without a cooperating broker and you're already middle class and can take the rest of the year off; sell five or six per year and you're pretty well-to-do.

The DOJ/FTC workshop writeup gave a lot of space to Chang-Tai Hsieh, an economist who found that "in cities with higher housing prices (and thus higher commission fees and higher profit opportunities for agents): (1) there are more real estate agents relative to the city's workforce; (2) these agents are less productive (measured by sales per agent or sales per hour worked); and (3) wages for agents are not higher than they are in cities with low housing prices." [FTC/DoJ report, p 47]

Artificially high prices will lead to abnormally high supply, so the rise in prices haven't benefited agents themselves, because more have just shown up. Individually, every REALTOR[®] has every incentive to perpetuate the awkward rules that make it difficult to negotiate down the commission, because then they'll make more on that one contract, but the collective result is that individual incomes are what they may be via an open market setup, but everybody has to hustle more to get clients. If you get the sense that REALTORS[®] are an especially aggressive bunch, now you know why. The only unambiguous beneficiary to artificially high pricing for real estate services is the NAR itself.