

A Response to “A Critical Assessment of the Traditional Residential Real Estate Broker Commission Rate Structure” (abridged) by Mark S. Nadel

By Barbara Nichols

Editor’s Note:

Last year’s edition of the *Cornell Real Estate Review* featured an article by Mark Nadel presenting a criticism of the traditional real estate broker fee structure, the perceived value of brokers’ services, and alternative compensation methods that, from the author’s point of view, would better serve the public (“A Critical Assessment of the Traditional Residential Real Estate Broker Commission Rate Structure” *Cornell Real Estate Review*, Vol. 5, pages 26-46). Following the article’s publication, Barbara Nichols, a seasoned residential broker in Los Angeles and Cornell alumna, submitted a rebuttal to Mr. Nadel’s stance. If a scholastic journal’s aim is to provide a platform for staging new ideas relevant to its trade, so should a journal encourage germane issues to be concurrently or sequentially debated. Thus, in the spirit of thought provoking debate accompanying an academic journal, the *Cornell Real Estate Review* presents Ms. Nichols’ defense of the residential brokerage industry.

In the 2007 *Cornell Real Estate Review*, author Mark Nadel presented the following premises in his article “A Critical Assessment of the Traditional Residential Real Estate Broker Commission Rate Structure”:

- I. Traditional real estate broker commissions are unrelated to either the quality of service or the value provided.
- II. Percentage-of-sale-price commissions do not serve the interests of home buyers and sellers.
- III. Brokers offering flat fee or hourly fees and performance based bonuses best serve consumers.
- IV. Residential broker fees should be negotiated based on the time it takes to sell a home as compared to other, similar properties.
- V. Residential brokers have established anti-competitive obstacles to protect themselves.

These five claims provide the critical springboard from which to counter last year’s published article.

author

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I. The Cost-Value Relationship of Brokerage Commissions

This rebuttal will include data and information omitted in what the author presented as a researched and scholarly dissertation. The article stated, as fact, that broker “fees may be inflated by \$30 billion annually,”¹ and that real estate broker fees do not accurately reflect brokers’ costs.

However, I can think of few if any professions where employees’ compensation truly matches their “costs.” Movie stars and athletes may be paid too much for the service they provide, far in excess of their benefit to the general public. Their “costs” have nothing whatsoever to do with their fees. This is commonly referred to as free enterprise and capitalism. Movie producers routinely take risks in paying astronomical salaries to movie stars in the calculated hope the actor will sell theater tickets and the movie will not flop. The sports team owner hopes the athlete won’t get hurt early in the season and will contribute to ticket sales.

Brokers are compensated for the services and expertise that they provide, and yes, their compensation (in the form of commissions) must cover their costs and provide a living. Still, if actual costs should be the basis of paying real estate brokers, the article should have attempted to give consideration to the operating costs of a broker’s firm such as:

- Offices, equipment, personnel
- Advertising of properties
- Programs to attract and train real estate agents
- Errors and omissions (E&O) insurance, liability and workers compensation insurance
- Health insurance and disability insurance
- Membership and participation in professional associations
- Licensing and MLS fees
- Transportation
- Attracting new clients
- Legal expenses

In addition to these daily business expenditures, an adequate cost analysis would need to reflect the cyclical nature of the real estate business and the burden of an agency supporting costs, not only in busy sales periods, but in slow markets as well.

Legal Liability and the Real Estate Agent

Nowhere in the article was an agent’s legal liability discussed. Estimates for E&O insurance vary by carrier and state, but typical premiums range from \$200-400 per agent per month. Minimum service requirements have been established in some states because real estate agents have a legal responsibility to their clients as fiduciaries. If an agent is merely acting as a marketing agent (placing the property listing in the MLS) and performs no other function required of a fiduciary, are they not violating state laws that mandate a fiduciary relationship for agents with their clients? Limited service and flat fee providers have yet to have these issues fully vetted through court cases, but no doubt will at some point.

The article alludes to services that “consumers are now often being denied, without their knowledge, and to their detriment,” in reference to agents supposedly not showing buyers all properties that meet their needs.² This claim is not based on any factual material. Most MLS services for agents require that listings be promptly placed in the MLS, usually within 48 hours

¹ “A Critical Assessment of the Traditional Residential Real Estate Broker Commission Rate Structure (abridged) by Mark S. Nadel. Cornell Real Estate Review, Vol. 5, pages 26-46, p26.

² *ibid*, p36.

from the time the listing is signed by the seller. The sellers have the option whether to place their listing on Realtor.com and some sellers actually decline to do this. Sellers can also choose not to have a real estate sign placed on their property or not to have a lockbox for buyer agent access.

Sellers are in no way required to purchase bundled services of traditional brokers, nor are buyers. Clients have no requirement to accept any bundled services from any firm, nor does any listing agent have the right to require a buyer to accept their firm's bundled services. Independent brokers usually prefer independent service providers and strongly recommend them to their clients.

There has not been a rapid escalation of the FSBO market or flat fee and limited service providers due to the internet because buyers and sellers value the services of brokers and are unwilling to pay for them. Capitalism and free enterprise prevail, not collusion and entry barriers.

The perceived "difficulty of the task"³ as it is called in assessing what real estate agents should be paid is quite literally impossible to project for any transaction. A property perceived as "difficult" may inexplicably sell quickly and a seemingly "easy" sale may become an extended ordeal. Because each home is unique, and sales are a function of market forces beyond the individual property, the "difficulty of the task" is simply not quantifiable.

The article says that departments of consumer protection and attorneys general should make a greater effort to investigate and prosecute cases where agents working with buyers clearly violated their fiduciary duties to clients. As an expert witness in hundreds of real estate transaction lawsuits, I would like to point out that violation of fiduciary duty for agents is a matter for civil litigation. Rarely, if ever, do our overburdened courts, prosecutors and departments of real estate have the time, finances or personnel to prosecute any agent or seller for fraud, let alone a violation of fiduciary duty. Incompetent agents can have their licenses suspended or revoked by state departments of real estate and this does occur. The author may be surprised to learn that the professional standards committees of real estate associations frequently fine erring agents; require that they attend ethics or other classes and sometimes kick them out of the association and the MLS. Some of these agents are referred to the state department of real estate by the real estate association for disciplinary action.

The article may want to reconsider its four questions for real estate agents after reading my book, *The No Lawsuit Guide to Real Estate Transactions*, chapter entitled "Select Your Real Estate Agent the Way You Would Select Your Brain Surgeon." These are the right questions to ask. Many substantive criteria are given to evaluate credentials.

Bonuses to sellers' agents for "quick sales"⁴ will not work. This would encourage precisely what the author objects to, negative incentives. Listing agents would be tempted to encourage a lower listing price just for a "quick sale[s]" thereby destroying, not creating, value for the seller.

"Capitalism and free enterprise prevail, not collusion and entry barriers."

II. The "Fixed Percentage of Sales" Commission is a Myth

The article asserted that "broker fees are usually set without regard to either the quantity or quality of service rendered."⁵ In reality, real estate fees are not "set" and are always negotiable between a listing agent and property seller. Fees to a buyer's agent are also not "set," and, if the buyer chooses, can be paid by a buyer's representation agreement.

There is no Multiple Listing Service (MLS) requirement concerning real estate commissions. The real estate agent can work without a commission if he so chooses. For example, the listing agent for a seller might agree to accept no commission on the seller's new home purchase if he is guaranteed the listing and commission on the seller's current property. If the agent receives two commissions on the two transactions described, he might accept a lower negotiated commission on each one.

³ *ibid*, p39

⁴ *ibid*, p29

⁵ *ibid*, p27

The article quotes a 6% commission as the standard set commission.⁶ There is evidence from a variety of sources that commission rates are trending down. REAL Trends data shows a decrease in commission rates of 16% from 1991-2004 and that drop may be even larger when additional benefits agents frequently provide to consumers are considered, like the free use of moving trucks and commission rebates.

Average commissions actually range from 4.3-5.4%. REAL Trends puts the average rate at 5.1% and it has been at this level since 2004. REAL Trends data shows a 5% average rate in the Far West and less than 4.8% in the Mid-Atlantic region. The Consumer Federation of America has found 12% of consumers paying commissions less than 3%; 20% paying 3-4%, 41% paying 5-6% and only 20% paying at least 6%. Almost 75% of consumers are paying less than the average commission of 6% cited in the article. More than 30% of consumers are paying 4% or less. In spite of referring to the REAL Trends data in the article, it was ignored that the data that does not support the point of view presented.

In an active market with many transactions, real estate agents may need to negotiate a lower commission in order to remain competitive. However, in our present slow market, some desperate sellers are now offering buyers' agents up to 10% commissions to help them sell their property. Supply and demand affects real estate commissions as it does other aspects of the economy. Real estate agents are motivated by income potential as much any reasonable professional.

The article attempts to analyze the split fee arrangements between agents and their employing broker. Split arrangements vary widely. Many full service brokers offer 100% commissions to agents with only an office fee "to cover their costs" and a small profit. Percentage splits for either the buyer's or seller's agent depends on the agent's experience, volume of business, participation in managing and training other agents and many other factors. The split commission arrangement is cited in the article as providing only limited motivation to the real estate agent to work for the highest sales price for the seller client. The article asserts that the buyer's agent is similarly unmotivated to seek the lowest price for the buyer because to do so would lower the commission the agent receives. Dual agency does create a conflict, and is prohibited in some states. Where it is allowed, real estate agents must exercise the greatest caution to provide advice without disclosing confidential information and to act with equal effort for the benefit of each party.

Even so, real estate agents are indeed motivated to seek the highest price for sellers and the lowest price for buyers. Why? Because real estate agents survive on client referrals. Both sellers and buyers need to conclude a deal feeling they have received value from the transaction. Only satisfied clients will refer the agent to their friends and relatives. Contrary to what the article stated, real estate agents have a great deal of motivation to get clients the best price, whether they are the seller or buyer. In 2004, almost 60% of homebuyers chose a real estate agent that they had used previously or who was referred by either a friend or relative.⁷

III. Hourly or Flat Fee Pay Structures Will Never Work in the Marketplace

The article outrageously claims that a 5% commission on a \$1,000,000 sale in a "hot" market is unwarranted, seeing as sellers may only need "10 hours worth of assistance with paperwork and routine closing tasks."⁸ All properties do not sell instantly in hot markets, and no real estate transaction takes less than ten hours of an agent's time. A typical transaction involves many hours and days of work, whether for a \$300,000 sale or a \$1,000,000 sale. The number of forms and disclosures required in a real estate transaction have amplified in recent years. In California there are at least 50 forms that may be utilized in any given transaction, and the typical transaction involves 20-25 documents. Most real estate offices have additional paperwork requirements to document when activities are carried out and to note when documents are signed. The typical

⁶ *ibid*, p28

⁷ National Association of Realtors, Research Division, Nov. 2005, "Structure Conduct and Performance of the Real Estate Brokerage Industry"

⁸ *ibid*, p36

real estate agent must deal with numerous property showings, property inspectors, property repairmen, attorneys, escrow holders, title companies, lenders, home warranties, appraisals, agent's property inspections and disclosures, building permits, environmental hazards and neighborhood issues. All of this cannot be done in ten hours.

It is a fact that limited service real estate companies charge less than full service real estate companies because they offer limited services. Some of these firms may charge only a flat fee for placing the listing in the Multiple Listing Service (MLS), leaving the seller or buyer to arrange all the necessary appointments and inspections, and to navigate the transaction without the guidance of an experienced broker. Most people do not buy and sell homes for a living, and therefore appreciate the skill, competence, and contacts of a full-service broker.

If there are limits to a flat fee structure, arbitrarily setting hourly fees would prove even more problematic in a free marketplace. The article proposes a sliding pay scale for real estate agents, but fails to provide specifics as to the criteria for that pay scale and the amounts to be charged based on the criteria. I question how the public would feel about paying \$300/hour for an agent with decades of experience, versus paying someone who is requesting \$150/hour but is greener and has fewer qualifications. Having spent decades in this business, I believe that most consumers, if not all, would choose the \$150/hour agent, even to their own detriment. I in fact agree that it would be delightful for real estate agents with 30 years of experience, advanced degrees, contractor's licenses and a host of other credentials to be paid more than those who are novices with limited credentials, whether buyers' or sellers' agents. The article does not discuss how to persuade the public that all agents are not the same and should be paid on merit. Unfortunately, the public tends to feel that all agents are created equal. Well qualified agents, including myself, do try to change this perception, but the public seems unwilling to conduct that sort of valuation. Real estate agents' value to their clients is their expertise, as is true for any profession, including their experience, education, knowledge of the market, contacts and sources which are unknown and unavailable to buyers and sellers. Ultimately, it is this expertise that buyers and sellers pay for, and not the accumulation of hours spent to close the deal.

Flat Fees and Fiduciary Duty

I do agree with the author's "harmful effects of hourly rates" analysis and do not believe that flat fees will overcome these harmful effects.⁹ Agents will spend only the time required to carry out services listed in the flat fee which may only include marketing and not any fiduciary duty to represent the interest of their client.

The author has clearly never acted as a licensed real estate agent. It is extremely difficult to persuade a buyer to pay their buyer's agent directly, or even to sign a buyer agent agreement before showing the buyer properties unless this is required as it is in some states.

The NAR Code of Ethics and the requirements of fiduciary duty in most states require a real estate agent to seek the best properties for the client regardless of the amount of the commission offered to the buyer's agent by the seller. An agent representing a buyer must exercise great care not to represent a seller representing themselves who is not a licensed agent affiliated with a broker, or risk dual agency and a fiduciary duty to both parties. Some states do not allow dual agency. Where dual agency is allowed, the agent representing both the buyer and the seller should receive more than the commission paid to an agent representing only the buyer or the seller, if asked to perform both functions. This total commission is fully negotiable. An agent assisting a seller, whether paid or not, and without an agency representation agreement will be deemed to be representing both buyer and seller and places themselves in a position of legal liability to both parties.

It is unreasonable to assert that buyers think using a broker costs them nothing; it is commonly known that a portion of the selling agent's commission will go to buyer's agent, and that when pricing a home, the cost of commission is factored in the price. However, without a broker, buyers

⁹ Nadel, p33

might actually pay more for a property, as most lack a broker's market knowledge and negotiation skills. Buyers and sellers seldom, if ever, can represent themselves without an agent or attorney and should not. Even if an attorney is hired to close the transaction, he or she will not refer a property inspector or geologist, show up at property inspections, assist with loan applications, advise on schools, neighborhood services, and so on. Attorneys generally review the contract and will sometimes perform the escrow function. A buyer and a seller can transact an agreement without a real estate agent by using attorneys, but will seldom receive the many services and the areas of advice about which real estate agents are knowledgeable and for which they deserve to be paid.

IV. Paying Agents Based on the "Quick Sale" and "Incremental Value" is Unfeasible

The article proposes that "quick sales" be measured against a benchmark of the average time comparable homes have taken to sell in the previous few months as a factor of value to determine the commission for agents.¹⁰ This is an unrealistic approach as real estate is cyclical. It is going up or it is going down, and days on market is a moving target. Each property is unique in location, design, neighbors, age, maintenance, traffic and myriad other issues. The article proposed a theoretical model, detached from the real world. Many sellers refuse to spend money to stage their homes for sale. Most sellers do want agents to provide maximum exposure of their property to potential buyers and the multiple listing service (MLS) functions very well in this regard. MLS listings are now available online to buyers at Realtor.com and many other websites. Sellers do want an expert's advice as to list price, but often do not take that advice, which increases the days on market. For example, I advised one seller, an accomplished attorney, to list his property for \$1,799,000 based on comparable sales and my experience in the area. He, however, insisted on listing the home at \$1,995,000. Over the course of several months, lower offers came in, and he turned them all down. The property was taken off the market for a month and the client was finally persuaded to relist at \$1,799,000. A week later a bidding war developed between two buyers and the property sold at \$1,800,000. Is it now clear why the model discussed in the article simply will not work? One year was spent trying to sell a property that should have sold in a few months if only the seller had taken my advice. The delay was due to the seller and not my efforts. This attorney client now listens when I advise him.

The article claims that a real estate agent should consider a \$12,000 commission sufficient to cover the standard costs to sell a \$200,000 home, and that the same commission should be equally sufficient to motivate them to sell a \$400,000 or even an \$800,000 home, so long as they "do not make any special efforts that produce incremental value." However, I would like to point out that legal liability is higher on an \$800,000 sale than a \$200,000 sale and so is the E & O insurance coverage for the agent. This has nothing whatsoever to do with special efforts that produce incremental value. The advertising and marketing costs are higher on more expensive properties, because as home prices increase sellers expect more extensive advertising exposure in pricey publications, which may or may not yield the incremental value the article describes. Advertising is not solely an effort by an agent to justify a higher commission, but rather to satisfy the demands of the client.

The author's description of a benchmark sales price and some sharing of gain over that price to give incentive to the agent to obtain a higher price would be quite impossible to compute using my listing and sale example above. The article does not describe how to calculate incremental value or extra value for either a buyer's or seller's agent in a buyer's or seller's market or somewhere in between.

The article refers to agents with "special ability and effort" justifying commissions or higher hourly fees.¹¹ How does the author propose to get the public to make that analysis? He seems

"Advertising is not solely an effort by an agent to justify a higher commission, but rather to satisfy the demands of the client."

¹⁰ *ibid*, p29

¹¹ *ibid*, p30

to give the buying and selling public a totally analytic and unemotional mindset. Buying and selling a home is an emotional experience for even the most level-headed person. The reality is that buyers and sellers choose real estate agents based on bus bench ads, real estate signs and cousin Bob's recommendation, and not an economic analysis of agent intelligence, education and competence, although many agents certainly wish they would.

The article claims that "competent agents should be able to quickly identify and avoid sellers who are seeking unreasonably high prices...[and] have little difficulty identifying buyers who are unrealistic about the market...before making any large investment of time."¹² Unfortunately, even competent real estate agents can have difficulty identifying some sellers and buyers who waste our time. Sometimes even reasonable buyers and sellers change their mind. Agents sometimes invest in a client in hopes of additional future business. The attorney client with the initial too-high list price of \$1,995,000 in the example will soon be selling his \$5,000,000 home and purchasing a smaller one story home in the area. Having now secured his respect and his appreciation of my competence and advice in selling his current property will allow me to make an excellent case to represent him in the upcoming transactions. He has also referred me to a friend who is interested in purchasing a home in the \$2,000,000 price range. It would be great if real estate agents could have what is sometimes referred to as a "breakup fee" in commercial transactions. An agent who spent considerable time with buyers or sellers who changed their mind would receive some fee for the time spent. Real estate agents certainly wish the author could persuade buyers and sellers of the wisdom and fairness in making this kind of fee payment to real estate agents.

V. Real Estate Brokerage Is an Excellent Example of a Competitive Market

The article quotes a comment from one source declaring that "the market for real estate brokerage service does not accord with the customary model of competitively functioning markets."¹³ This statement is in complete contradiction with reality.

Of the traditional real estate brokerage firms, more than 75% of all residential real estate companies are independent companies. There are more than 200,000 locally owned real estate offices and branches in the United States. The top 100 real estate firms hold only a 17% market share. There are approximately 2.5 million licensed real estate agents and nearly all are self-employed independent contractors. The industry is fiercely competitive, allowing agents ease of entry and exit from the profession.¹⁴ "The number of franchise brokerages is growing too, with almost a dozen players emerging in the market in the last half dozen years, many of them touting business models built around discount or fixed fee pricing."¹⁵

The U.S. Government Accounting Office (GAO) cited in a study conducted in 2005, that competition in real estate is "based on variables such as quality, reputation and level of service", and also says real estate brokerage "has a number of attributes that economists normally associate with active price competition," and it goes on to list them.¹⁶ They include the large number of brokerage firms and individual licensed brokers and agents, and the lack of dominance by any firms in most markets, among other things.

There is widely available evidence that the real estate industry is a mosaic of many different types of brokerage models. A report by the Consumer Federation of America, released at the

¹² *ibid*, p31

¹³ *ibid*, p28

¹⁴ National Association of Realtors, Research Division, Nov. 2005, "Structure, Conduct and Performance of the Real Estate Brokerage Industry"

¹⁵ REALTOR Magazine, The National Association of Realtors, September 2007, "Affiliation Up," by Robert Freedman, p.FB2-FB8

¹⁶ GAO-05-947 Real Estate Brokerage, pp 8-9.

end of 2006 provided clear evidence that alternative models that charge fees on the basis of services rendered have enjoyed explosive growth. The CFA report cites a REAL Trends figure that nontraditional brokers in 2005 accounted for more than 1 in 10 brokerages. It also cited almost a six-fold growth in a trade association representing these alternative brokerages from 2001-2004. A Realtor Magazine franchise report (September 2007) noted that the business model of almost half of all emerging real estate franchise companies is based on either a discount or flat-fee based system.

“Real estate agents and brokers compete actively amongst themselves for business. They also compete with consumers. Homeowners can always choose the do-it-yourself route. In 2004, 14% of home sales were “for-sale-by-owner” commonly known as FSBO’s.”¹⁷

The article uses a quote that “the industry has channeled competition towards providing consumers with two, dubious benefits: 1) a surplus of new, inexperienced agents, and 2) free promotional gifts, such as refrigerator magnets and the like.” This quote disparages an entire profession and is unjustified.

In Summary

Having been cast as money grubbing, ineffective, shady and dishonest, there are a few more points I would like to make in summary.

Real estate agents are entrepreneurs and independent contractors. They do not have the security of a weekly paycheck, nor do they have paid vacations or employer benefits and many real estate agents work well over 40 hours per week, often beyond the bounds of a 9 to 5 workday. Since buyers and sellers of real estate work too, many brokers find themselves working on weekends and evenings around their clients’ schedules.

The article’s author surely believes his work contributes to society. Real estate agents believe their work does as well. They help buyers and sellers realize the American dream of property ownership to the tune of \$1.4 trillion in home sales volume according to REAL Trends data in 2004. Most are hardworking, honest and fulfill their fiduciary duties. They deserve what they are paid in real estate commissions and, yes, sometimes even more! The typical real estate agent in 2004 earned \$38,300 and worked 45 hours per week. According to an NAR survey of its affiliated members, 54% of all Realtors are women.¹⁸ Real estate is an occupation open equally to both sexes that allows flexibility of work hours. No one tells a woman who is a successful agent “you’re making too much for a woman.” Equal employment opportunity for women is an important economic value to our society, and at \$38,300 average income they are not getting excessively rich. There are no work stoppages. Agents are free to move from company to company and to start their own company.

Real estate is not a commodity. Each home has its own unique features and location. Each home requires a different marketing presentation. A home is the largest purchase that a person will likely make in their lifetime, and a transaction that most people will only undertake a few times. Since so much is riding on this one transaction, it only makes sense to retain a professional who has the expertise to bring the sale or purchase to a successful close.

Opinion Research Corporation conducted a survey of people in June of 2006 who had used the services of a real estate agent or broker in the last five years. This data was analyzed by Stephen Brobeck, executive Director of the Consumer Federation of America. The data showed that 84% of those surveyed viewed the services of their real estate agent favorably.

¹⁷ National Association of Realtors, Research Division, Nov. 2005, “Structure, Conduct and Performance of the Real Estate Brokerage Industry”

¹⁸ National Association of Realtors, Research Division, Nov. 2005, “Structure, Conduct and Performance of the Real Estate Brokerage Industry”

At the annual convention of the National Association of Realtors in November of 2007, some 30,000 real estate agents gathered to learn ways to better serve the public through new technology, to find out about new resources to educate themselves and help them grow their businesses. As a speaker at the convention, I shared with these agents how to better serve their clients and how to avoid lawsuits for themselves and the parties they represent. My lecture was derived from the content of my book, *The No Lawsuit Guide to Real Estate Transactions*. I would like to recommend this book to Mr. Nadel. He may need it the next time he sells his home without an agent.

