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Editorial

Playing With House Money

A recent working paper released by the Boston Fed examines the effects of the inherent conflict of interest between a seller of a house and the real estate broker hired by the seller.

In it, the authors outline a compelling (if not exactly clear or concise) scenario in which agent/broker best interests in a home sale are almost always directly inverse to a seller's best interest. The prevailing industry standard of 6 percent commission on sales, no matter the final sales price or how long the sale took, only compounds the problem.

Consider the basics: a seller wants to get the most money possible for his home in the shortest amount of time possible. An agent, ostensibly, wants the same things.

But the inevitable calculus of any transaction, particularly home buying and selling, tilts the variables on their head.

Higher listing/asking prices mean a property spends longer on the market. The longer a property stays on the market, the more sellers pay in terms of maintenance costs, taxes, staging, etc. Brokers, of course, have their own listing costs, but it can be safely assumed these are less than the seller's.

The Fed concludes that because a broker's fee is fixed, a broker has more to gain by selling at a lower price, but in a faster amount of time, than he would by holding out for a higher price.

The longer a property sits on the market for the seller, on the other hand, dictates an increase in price to cover their own costs. But, perhaps cruelly, every time the price goes up, the probability of a sale goes down.

Still further, in many sales, a seller relies on a broker/agent's assumed expertise in a given market to set a price point on their behalf, never mind the fact that a seller almost never dictates a broker's commission.

In the interest of leveling the playing field, the Fed outlines a (highly) theoretical situation in which a seller actually can determine a broker's commission. In this scenario, a seller can theoretically come out on top in two ways: by either minimizing the commission paid to the agent, or by maximizing the selling price of their property.

In order to pay the lowest possible commission, and to maximize value, a seller’s costs of keeping a property listed must be considerably lower than an agent’s, given the fact that high listing costs motivate an agent to sell quickly and for more value to the seller.

In order to secure the highest possible price for a home, both the seller and the agent’s cost of maintaining a home on the market must be incredibly low, since higher-priced homes take longer to sell.

Both of these scenarios seem unlikely.

Finally, the Fed argues, a percentage commission on sales, rather than a lump sum fee, generates an incentive for brokers to exert more effort on selling more expensive homes than on low-value homes.

And so, just as the current housing slump is double-barreled (falling prices, flagging sales), so too is the Fed’s attack on the current real estate agent system. The system drives down prices by rewarding speedy sales over high prices, and drives down sales by dictating agents focus on a handful of high-priced properties at the expense of masses of middle and low-end homes.

In this sense, it can be argued that the real estate commission system itself is to be blamed, although that ignores the parallel conclusion that this paradox exists in other industries as well. Stock brokers paid on commission care only that their clients actually buy shares, not necessarily at which price they are purchased.

Were we to offer some form of rebuttal to the Fed’s otherwise engaging and interesting argument, we might say the Fed offered little in the way of calculations as to the value of a good Realtor’s network, local knowledge and deal-making abilities. Certainly, these finely-tuned attributes add much to a seller’s peace of mind, if not his bottom line.

But still, we can’t help but come to the conclusion that when the seller is in the game, the house, or rather, the agent selling the house, always wins.

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