

BANKER & TRADESMAN

THE REAL ESTATE, BANKING AND COMMERCIAL WEEKLY FOR MASSACHUSETTS

ESTABLISHED 1872

COMMENTARY

Discount Brokers See Friction, Opportunity as Fee Models Evolve

By Walter Hall

THE WINDS OF CHANGE ARE BLOWING IN THE real estate industry, as the days of the 5 percent and 6 percent commissions for traditional real estate brokers are starting to decline. While Massachusetts did not blaze the trail in the trend toward reduced broker fees, it is following the lead from other regions of the country where the concept of reduced broker fees has taken strong hold.

What has led to this paradigm shift? How is it affecting relationships between the reduced-fee and traditional brokers, and what does it all mean to the industry?

As someone who has worked in real estate both locally and nationally for over 40 years and practiced in both models (traditional and reduced fee), let me offer a simple overview of the difference. In the "good old days" (so characterized by those who cling to the idea that a 5 percent or 6 percent commission is the standard that all should follow), a seller put a home on the market and let the broker do all the work – from marketing to showing the home. Sellers expected that they would pay 5 percent or 6 percent of the final sale price in exchange for this service.

This was the accepted way of doing business for many years. However, a number of factors have come into play which have lessened the stronghold grip that traditional brokers have had on commission levels – and this has been of immense benefit to the home-selling consumer.

Today's real estate world is very different and more complex than one that many remember from several decades ago. First, home prices have escalated far beyond the inflation rate. Beyond escalating real estate prices, the Internet has opened many doors for the marketing of properties and the availability of knowledge of all facets of what real estate sales is all about. As a result, today's



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sellers are in a better position to take a more active role in the real estate transaction.

Locally, the number of houses that come on the market under either "for sale by owner" (FSBO) or other non-traditional (reduced-fee) arrangements is approaching 10 percent of the total, and it's reasonable to speculate that this number will at least double in the next five years.

Sellers who understand the enormous power of the Internet and who are looking to avoid a hefty commission (under a traditional arrangement a house that sells for \$400,000 would cost the seller at least \$20,000 in commissions) have increasingly turned to reduced-fee agencies and FSBO opportunities. They come in many shapes and sizes, keeping in mind that under the traditional 5 percent commission approach the listing broker normally gets 2.5 percent of

the commission and the selling broker gets the other half. Some agencies simply offer to provide traditional services at lower rates – for example, 1.5 percent for the listing broker commission. Others charge a fixed fee, regardless of the sale price. My firm provides a choice of either a reduced commission or fixed fee and also offers a choice of payment plans.

Emerging Model

The FSBO effort, without professional guidance, often results in frustration for home sellers who quickly discover that they lack the ability to negotiate effectively, may spend hours and days scheduling appointments or may not be able to effectively determine a prospect's likelihood of securing timely financing. For these and other reasons, the various non-traditional fee structures are taking hold.

With this trend on the upswing, it raises the question of what happens next. Conventional wisdom ought to dictate that the larger traditional brokers should already understand that they cannot indefinitely do business the old-fashioned way and that the market, sooner or later, will no longer support a 5 percent commission structure.

I believe that even those traditional brokers who are sticking to their guns do recognize the shift that is taking place. How could they not? The news media has generally supported the concept of more reasonable broker fees, holding to the notion that the old way cost homeowners far too much money for the services performed.

Regardless of whether that is a valid argument, what appears to be happening in the market is that smaller to mid-sized brokers are adapting their structure to accommodate the winds of change. However, the big players have dug their heels in and continue to do business in a certain way because that's

Continued on Next Page

Continued from Previous Page

the way they've always done it and their cash flow and profit models are geared that way.

Such thinking is not unique to the real estate industry. Established businesses with large market share often are slow to react to a genuine competitive threat. They somehow think or at least hope that the threat will be short-term. There has been some discord between the traditional and reduced-fee agencies in the industry, although not as much as widely might be believed. The argument can be made that there is room for both. Certainly the leading industry organizations, such as the National and Massachusetts associations of Realtors, accept all practitioners and are staying neutral on the subject.

There is some friction, more on the side of the traditional brokers, some of whom will try to spread the message that reduced-fee brokers charge so little because they do so little. Some also float a statistic that, in the opinion of this writer, is completely bogus. It goes like this: Home sellers will get, on average, 15 percent more in sale price with a traditional broker than they would with a reduced-fee broker. Both allegations are untrue. There is absolutely no documented evidence to show that traditional brokers bring about higher sales prices for home sellers. It is little more than an attempt by traditional brokers to jus-

tify higher fees. Buyers ultimately control the sale price – brokers don't.

In addition to the claims being false, there is the larger truth that businesses seldom gain by speaking ill of their competitors. It's been my experience that most customers will see through this ploy every time.

In some of the larger traditional brokerage houses, it is a corporate policy that they will not vary from their model, which is a 5 percent or 6 percent commission for a one-size-fits-all service package. Several of the larger brokerage firms are owned by huge, publicly traded entities, and it is unlikely that there will be any change in their commission structure. At least, they won't change unless they are faced with the economic reality that their market share is decreasing, as well as their revenue and profits.

Most reduced-fee brokers promote the concept of providing more choice, more flexibility and less cost, and this resonates with home sellers. And for those reduced-fee agencies that can deliver on those promises, this bodes well for the consumer. And nothing helps a trend grow like word of mouth from satisfied customers who legitimately can claim that they sold their homes for a good price and saved on in commissions in the process.

For the record, in our practice we have ac-

tually received a few referrals from traditional brokers. These referrals are typically a friend or family member of an agent who has asked for a more reasonable commission but were turned down by the agent's firm, which chose to hold the line on the traditional commission. While I see the relationship between the traditional and reduced-fee brokers as outwardly cooperative, I do not see a lessening of the highly competitive atmosphere inherent in the practice of real estate.

It may well be that the seller who chooses to remain totally uninvolved in the sale process, the "I just want it done" type, may continue to prime the pump of the full commission houses. But I believe there will continue to be a lessening of the numbers of home sellers who are willing pay to these big fees, and those brokers who steadfastly refuse to change their business model will face the choice of either acknowledging the shift and adjusting their fee structure accordingly or continuing to watch their market share erode.

I believe there is enough professionalism in the industry for coexistence between the reduced-fee and traditional brokers, but I believe the reduced-fee brokers are the ones that will emerge strongest in the changing marketplace. And that's good news not only for the real estate industry, but for the home sellers they serve. ■

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