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Real estate industry trembles over commissions on home sales

After jurors recently found that there was a scheme to inflate commissions, experts say changes could shake up the business

By Julian Mark

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Agents on each side of a home sale split a commission that typically ranges between 5 and 6 percent of the price. (iStock)

Florida Realtor Alexandré Worthington is already bracing for a shift that threatens to tear down a compensation system that has ruled his industry for more than a century.

“It’s the perfect time to pick up the pieces,” Worthington said. “It’s a perfect time to reflect on the changes that could be coming and how to prepare for them.”

In a federal civil case, a Kansas City jury last month found the National Association of Realtors (NAR) and major brokerages conspired to keep commissions artificially high. The result has left the real estate industry holding its collective breath, as experts say it is on the cusp of a radical reorganization that could affect everything about the business.

"There's a lot of speculation out there around how this will play out," said Ryan Tomasello, who covers the real estate technology sector for Keefe, Bruyette & Woods. Although much remains uncertain, "we have a high degree of confidence that, at the conclusion of this storyline, significant changes will be made to the commission structure in the U.S."

The most immediate and striking blow could come as a result of the federal case in Kansas City, Mo. The judge overseeing the case has the power to issue an injunction that could break up the century-old "bundled" or "cooperative" commissions system, in which sellers' and buyers' agents split a commission that typically ranges between 5 and 6 percent of the home sale price. The timing of such an action remains unclear.

A settlement in which NAR agrees to change the system is also possible, according to Michael Ketchmark, the lead plaintiff attorney. "We're in the process of having conversations with the [Justice Department] and NAR, and we remain hopeful that we're going have a resolution that brings relief to millions across the county," he told The Washington Post.

In 2019, a group of home sellers sued NAR and brokerages Keller Williams and HomeServices of America in the Kansas City federal court, accusing the organizations of conspiring to keep commissions artificially high by requiring sellers to make the cooperative commission offer before listing homes on a widely used property database — the Multiple Listings Service — that allows for-sale properties to receive notice. The plaintiffs alleged that the system stifled competition and inflated commissions for buyers' agents.

NAR, Keller Williams and HomeServices of America have denied those allegations and vowed to appeal the Oct. 31 verdict that awarded $1.8 billion to a half-million Missouri home sellers, an amount that could swell to $5 billion. Those organizations say the existing commissions structure is transparent, and they denied that the payment structure was anticompetitive. NAR said after the verdict that the "matter is not close to being final."

Mantill Williams, an NAR spokesman, said the association is open to a resolution that "maintains a way for buyers and sellers to continue to benefit from the cooperation of real estate professionals and eliminates our members' risk of liability for the claims alleged."

"That being said," he added, "we remain confident we will prevail on our appeal."

But the verdict has already sent convulsions through financial markets and the real estate industry.

Shares of Zillow plunged nearly 7 percent after the jury rendered its verdict, as investors saw potential changes as a threat to the company's revenue model — a large portion of which comes from advertising for buyers agents, according to analysts. During an earnings call a day after the jury verdict, Zillow chief executive Richard N. Barton sought to reassure Wall Street analysts that buyers agents would not go extinct and that the company's revenue model was safe.

He added that possible developments to the commissions system "look like good initial steps at more transparency and education for consumers," though added that he believed any change would come slowly.

Changes to the commissions structure could eventually result in a 30 percent reduction in the $100 billion total that U.S. consumers pay in real estate commissions, according to a report by Tomasello and his team. Analysts and real estate experts said prices for buyers' agents would adjust more accurately to the value of their services. If buyers' agents are no longer guaranteed 3 percent of the commission, their fees might fall because they would have to compete on the price of their services, experts said.

Worthington, the Florida Realtor, said buyers' agents could shift to an "a la carte" service model, in which potential home buyers choose their level of service and pay accordingly. A 1 percent commission, for example, could buy a customer automated emails with new homes for sale, based on the preferences of a prospective buyer, he said.

For a 3 percent commission, "I'm actually going to walk into my office every morning and scrub our system and every resource I have to find the house that you're looking for," he said.

Sophia Gilbukh, an assistant professor of real estate at Baruch College's Zicklin School of Business in New York, said breaking up the buyers' and sellers' agent commissions could also result in lower listing prices for homes.

High fees borne by sellers result in higher listing prices, Gilbukh said, because sellers want to cover their costs. Higher prices increase mortgage payments for buyers, she said.

Breaking up the commission system, Gilbukh said, would result in lower prices overall but also lead to bigger upfront costs for buyers, who indirectly pay the costs of the commissions in the form of higher mortgage payments. Without the structure of the current cooperative system, buyers would need to directly pay their agents immediately after a sale.

"That might put a lot of buyers at a disadvantage, especially liquidity constrained buyers," she said. "They might not be able to afford a higher-fee agent — even if it's worth it for them — because they just don't have the money to pay for it upfront."

The cooperative compensation structure was established in 1913, when National Association of Real Estate Exchanges, the precursor to NAR, said its member agents should share commissions with agents that produced buyers, according to a 2015 study by economists Panle Jia Barwick and Maisy Wong. The commissions rate hit 5 percent in 1940 and has remained virtually unchanged ever since, according to the study.

Commissions work differently in countries such as the United Kingdom, where sellers pay typically less than 2 percent, and buyers pay their own agents, according to the study.

U.S. regulators have long scrutinized America's commission system, Tomasello, the analyst, said. In 2020, the Justice Department sued NAR and proposed a settlement in which the association would have to change its rules to bring more transparency to its commission system. The settlement also sought to stop NAR from saying buyers' agent services are free. But less than a year later, the Justice Department withdrew from the settlement to "permit a broader investigation of NAR's rules and conduct to proceed without restriction."

The Justice Department has also filed statements of interest in the Missouri case and a similar civil case in Illinois that clarify the parameters of a 2008 settlement between NAR and the Justice Department involving online listings. It did not respond to a request for comment on settlement negotiations in the Kansas City case.

Echoing the Missouri and Illinois cases, a new group of Missouri residents filed a proposed lawsuit Oct. 31, alleging that real estate agents are conspiring to keep commissions high, restraining price competition and harming consumers in violation of federal antitrust laws. The lawsuit seeks damages for home sellers nationwide.

Carole Higgins, a real estate agent in Suttons Bay, Mich., said changes are long overdue because agents have largely failed to appropriately explain contracts and commissions to consumers.

"We've grown so sloppy with the way that we are training our Realtors that this was the natural outcome," Higgins said of the lawsuits. This "is a wake-up call."