

Real Estate Commissions and Home Search Efficiency

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In the U.S. residential housing market, homebuyers' agents typically offer free house showings and collect a commission equal to 3 percent of the price of the home bought by their clients. Our analysis shows that, by deviating from cost basis, this compensation structure may lead to elevated home prices, overused agent services and prolonged home searches. We explain that shifting to a simple a la carte compensation structure may improve home search efficiency and social welfare.

Commissions for real estate agents has long been a controversial issue in the U.S. residential housing market. In this article, we discuss some of the criticisms of the traditional commission model and examine an alternative compensation model that may better align incentives and help reduce search frictions in the housing market. (See also our 2023 article "[Removing Conflict of Interest for Agents of Homebuyers](#).")

Homebuying in the U.S. and in Other Countries

Despite technological advances substantially lowering home search and matching costs, real estate agents continue to command relatively high-percentage commission rates. In a typical housing transaction, the seller pays her agent a 6 percent commission, with half of this amount passed to the buyer's agent. For example, a house sold for \$400,000 would result in a \$12,000 commission due to the buyer's agent and an additional \$12,000 to the seller's agent. While buyers do not pay commissions directly, they are likely to pay them indirectly through higher home prices.

This level of commission — especially the buyer-agent commission — makes the U.S. an anomaly. According to surveys from 2002 and 2015, [sellers typically pay less than 2 percent](#) in the U.K., Ireland, the Netherlands, Singapore, Sweden and Norway.¹ In fact, buyers in many countries — such as Australia, Canada and Denmark — commonly purchase properties without agent representation. Also, when buyers' agents are involved, buyers

typically pay their agents directly, as in the U.K., China, Japan and Italy.

Controversies and Concerns With Commissions

Comparing across industries, the persistently high real estate commission is also puzzling. In the past few decades, the internet has squeezed margins in many sales and advisory professions. For example, the number of employees has declined drastically in travel agencies, while many financial advisors — who used to charge between 1 and 2 percent of the assets they managed for clients — have shifted to fee-for-service models.

In the housing market, however, nearly half of buyers now find their homes independently online, yet 87 percent of buyers still end up retaining an agent, and commission rates have barely budged. Meanwhile, the National Association of Realtors (NAR) reached 1.36 million members by December 2018, a historical high.²

Policymakers and industry observers are concerned that real estate commissions deviate from underlying costs. With a uniform percentage rate, the commissions are unrelated to the quantity or quality of the service rendered. Rather, the fee is based solely on the price of the home. However, there is no evidence that buyer agents incur higher service costs when assisting buyers shopping for higher-priced homes than buyers shopping for lower-priced ones. Also, the way that buyer agents are paid by sellers, rather than by buyers directly, may mislead buyers into believing and acting as if they receive free services.³

Currently, multiple lawsuits are filed against the NAR and major national brokerage companies regarding such commissions, and a Kansas City jury determined in a \$1.8 billion judgement last October that commissions had been inflated and that brokerages and industry groups conspired to keep them that way.⁴

Meanwhile, real estate agents have been vigorously defending the traditional commission system. They argue that such a system serves the best interest of their customers, supports market-driven pricing and advances business competition.⁵

An Economic Analysis

To assess the way commissions are structured, we conduct a formal economic analysis in our recent working paper "Real Estate Commissions and Homebuying." For that purpose, we construct a model of home search and buying in the U.S. residential housing market. In the model (as in reality), homebuyers attend house showings without paying their agents out of pocket. Buyers' agents receive commissions equal to 3 percent of the house price after the home is purchased.

We show that such a compensation structure deviates from its cost basis in two ways. One is the agents' extra profits, which push up buyers' final costs of purchasing a home. As a result, buyers must be more selective in their home search to justify the purchase. Another distortion comes from the "free" house showings offered by buyer agents, which lower

buyers' marginal cost of home search and induce home buyers to search too much. Together, the two distortions lead to elevated home prices, overused agent services and prolonged home searches.

Using our model, we also conduct a quantitative analysis. The results show that switching to cost-based compensation — in which buyer agents do not earn extra profits and buyers pay for each house showing — may increase U.S. homebuyers' welfare by more than \$30 billion per year. Most of this gain in homebuyers' welfare comes from the redistribution of buyer-agents' profits. Net of the redistribution, however, social surplus (that is, the sum of consumer welfare and agent profit) increases by about \$800 million per year.

Implementing such a cost-based compensation system does not mean that policymakers should regulate the level of commissions directly. Rather, a simple a la carte approach to compensation can achieve efficiency in this market. In the a la carte approach, sellers and buyers each pay their agents directly, and buyers pay their agents for each task separately, independent of the final price of the home bought. This compensation system allows buyers to shop for each service they need and bargain for the price. Under such a system, competition among agents would likely align agent compensation with cost, and buyers would not overuse agent services.

We also use the model to assess another option: capping buyer-agent commissions at a lower percentage rate while keeping the current compensation structure in place. We find that a uniform commission cap would increase consumer welfare but with potential negative effects on buyers of lower-priced houses, as buyer agents would find it unprofitable to serve this market segment. Therefore, a commission floor would be needed to support lower-priced housing transactions. Another alternative could be to use nonuniform caps to moderate buyer-agent profits while avoiding the no-service problem, but that may overcomplicate the implementation. In comparison, we argue that the a la carte approach works better, as it does not require policymakers to control commission levels and it addresses the externality caused by free house showings.

The a la carte compensation system may also provide additional benefits. Given that a la carte commissions do not increase with house prices, helping buyers negotiate the lowest possible home prices would no longer conflict with buyer-agents' self-interest. Also, economic efficiency is often improved when products are unbundled because separate prices for smaller pieces of products or services allow the market mechanism to better match providers' costs to consumers' marginal willingness to pay. Further, a la carte pricing means buyers would no longer have to work exclusively with a single agent throughout the search process. Clearly, some agents are better than others, and the risk of getting contractually tied to a less productive agent looms large for homebuyers.

Broader Considerations for the Homebuying Process

In our analysis, the current buyer-agent commission rate is treated as given, but the reason

real estate agents can command higher-than-cost commission rates is related to the specific industry structure. To facilitate home search and matching, agents pool home listing information into a multiple listing service (MLS). To appear on the MLS, a listing is required to specify the commission offered to buyer agents. Sellers are concerned that buyer agents could steer their clients away if their listing does not offer the same buyer-agent commission rate as every other listing. Several empirical studies have shown that these concerns are indeed valid.⁶ In this regard, the a la carte system favored by our analysis requires buyers to pay their agents directly instead of through sellers, which eliminates buyer-agents' incentives for steering.

High real estate commissions also have broader welfare consequences. They impose a financial burden on households and may induce significant lock-in effects that limit household mobility.⁷ Moreover, multiple studies have shown that lucrative commissions have driven excessive entry of agents and brokerage firms, which causes misallocation of talent and resources.⁸ For example, the U.S. has around six times more housing transactions than the U.K. (where commissions are lower) but has 26 times more agents. Thus, agent productivity is significantly lower.⁹ Therefore, shifting to a cost-based a la carte compensation model would not only improve housing search efficiency but also save a great amount of agent talent and resources, allowing them to be put to more productive uses.

While the issues we analyze are in the housing brokerage sector, they broadly connect to many other network markets (or trading platforms) that feature two-sided externalities.¹⁰ For example, in payment card markets, card networks typically require merchants to pay a percentage fee (called an interchange fee) to card issuers, which is analogous to the buyer-agent commission in our analysis. For both types of networks, percentage fees are not based on costs but rather on users' willingness to pay, which is a form of price discrimination.¹¹ These fees allow the networks to profit and grow, which is arguably necessary for a network at its nascent stage. However, as the network reaches maturity, the extra profits become less justifiable. Consistently, our analysis suggests that a relatively straightforward reform of the traditional U.S. real estate commission model could improve the performance of the housing brokerage sector.

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¹ See the 2019 article "Competition in the Real Estate Brokerage Industry: A Critical Review" by Panle Jia Barwick and Maisy Wong.

² See the 2019 article "The Internet Didn't Shrink 6% Real Estate Commissions. But This Lawsuit Might" by Lydia DePillis.

³ In a recent court filing, the U.S. Justice Department refers to the brokers' commissions as "artificially inflated" by the industry's practices. See the Feb. 16, 2024 article "[Justice Department says settlement too lax in real estate commission case](#)" by Mike Scarcella.

⁴ See the 2023 article "[Why Are Real Estate Commissions 6% — and Why That May Be Changing](#)" by Anna Bahney.

⁵ See the Oct. 31, 2023 article "[Realtors found liable for \\$1.8 billion in damages in conspiracy to keep commissions high](#)" by Elisabeth Buchwald.

⁶ Examples of such studies include the 2017 paper "[Conflicts of Interest and Steering in Residential Brokerage](#)" by Panle Jia Barwick, Parag Pathak and Maisy Wong and the 2023 working paper "[Et Tu, Agent? Commission-Based Steering in Residential Real Estate](#)" by Jordan Berry, Will Fried and John William Hatfield.

⁷ See the 2010 paper "[Housing Busts and Household Mobility](#)" by Fernando Ferreira, Joseph Gyourko and Joseph Tracy.

⁸ See the 2003 paper "[Can Free Entry Be Inefficient? Fixed Commissions and Social Waste in the Real Estate Industry](#)" by Chang-Tai Hsieh and Enrico Moretti and the 2015 paper "[The Costs of Free Entry: an Empirical Study of Real Estate Agents in Greater Boston](#)" by Panle Jia Barwick and Parag Pathak.

⁹ See the previously cited 2019 article "[Competition in the Real Estate Brokerage Industry: A Critical Review](#)" by Panle Jia Barwick and Maisy Wong.

¹⁰ See the 2002 paper "[Cooperation Among Competitors: Some Economics of Payment Card Associations](#)" and the 2006 paper "[Two-Sided Markets: A Progress Report](#)" both by Jean-Charles Rochet and Jean Tirole.

¹¹ See the 2017 paper "[Ad Valorem Platform Fees, Indirect Taxes and Efficient Price Discrimination](#)" and the 2018 paper "[Should Platforms Be Allowed to Charge Ad Valorem Fees?](#)" both by Zhu Wang and Julian Wright.

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