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Rebates: Good for Consumers, Good for Brokers

Summary

The Internet has been a catalyst for new business models in real estate brokerage, just as it has in other industries. With the advent of the Internet, real estate agents and brokers immediately found ways to improve their existing businesses, and many also developed new business models.

Some brokers use the Internet to manage the consumer shopping experience, finding that agents are more efficient when consumers shop and explore online. Brokers and agents can direct consumers to their own website or delegate some of the work to an online broker. Other brokers found new ways to market their services online, and it's much more than just banner ads and a website.

There is room in the industry for many different business models, and competition among different business models is good for the industry.

Yet, some still support barriers to competition such as state limits on consumer rebates. Rebates are an excellent tool brokers and agents may use to compete – offering rebates is essentially a method of price competition, used to gain new consumers and to better compete in a crowded marketplace. As we show in this paper, rules limiting rebates are not justified by any legitimate consumer protection concern.

Unleashing agents and brokers to shape their own businesses, to find the model that is appropriate for their situation and market, will benefit both consumers and the industry. Removing barriers to competition, such as anti-rebate rules, should be a priority for industry leaders and policymakers.

A rebate lowers the price.

It does not take significant analysis to understand that a rebate is, essentially, a reduction in the cost of the services provided.[1] A consumer purchasing a house realizes lower transaction costs by receiving a rebate from the broker's commission.

Why brokers offer rebates.

Brokers often use rebates because the mechanics of the typical real estate transaction make a price reduction difficult for a broker working with a buyer.

It is customary for the seller's broker to split the commission with the broker working with the buyer. When a buying consumer is shopping for a broker, he or she is usually told that the broker's services are "free," that the seller will pay.[2]

If a broker wishes to reduce the price of his services to gain new consumers, how would he or she do that for buyers? In theory, the home seller could accept a lower nominal purchase price in return for the seller's broker giving less commission to the broker working with the buyer – the home seller and the seller's broker would still net the same proceeds. This process is difficult to negotiate in advance and is confusing for most buyers and sellers.

A rebate, on the other hand, from the broker to the buyer, accomplishes the price reduction with ease. Rebates are a simple way for a buyer's broker to lower his price to the consumer.

A second reason brokers use rebates is that some consumers actually prefer a reward in a form other than cash or a reduced price. A broker might offer a gift card to a local furniture store, or for a landscape service, or airline miles. Brokers can often purchase these products in bulk or at reduced wholesale cost, so in some cases a broker is able to offer a greater value to a consumer through a non-cash reward.

Rebates are used by many brokers.

Many membership organizations find that real estate rebates provide value to members. Membership organizations such as credit unions, Costco, and USAA find that they are able to deliver value to their members by offering access to lower real estate commission costs through rebates.[3] Members of these groups are often excellent customers, so local brokers are willing to give back value in order to participate in the program.

These arrangements are a "win-win" – local brokers receive a steady stream of qualified and motivated consumers, and consumers receive a deal that would be difficult to obtain without the pre-arranged rebate. Many brokers around the country participate in these networks. Of course, local brokers that don't wish to offer a rebate are the parties who might have a complaint.[4]

The Internet encourages the use of rebates.

Rebates are often offered through Internet real estate brokers because the Internet enables new efficiencies that can be passed back to consumers. The RealEstate.com business model illustrates this point.

RealEstate.com built a network of local real estate brokers and agents that provide full service brokerage to consumers. Each broker and agent has signed up to be part of the network, and each feels they get value from it, otherwise they would not use it.

RealEstate.com works to cultivate consumers who are serious and ready to buy or sell. We supply information and tools to each consumer while they are in shopping mode – allowing consumers to dream, look, shop, learn, and explore online – until the consumer is ready to work with a local agent. Because RealEstate.com performs this task for our local agents and brokers, the agent and broker becomes more efficient, focusing on buying and selling homes for ready clients, not cultivating shoppers.[5] If a consumer closes a sale with one of the agents or brokers using our system, the broker pays a cooperative brokerage fee to RealEstate.com very similar to the fees brokers routinely pay to relocation companies and other services.

Consumers using RealEstate.com are offered a rebate. This offer of value typically increases the consumer's commitment to close a deal, and this adds greater value to agents and brokers on the network.

The new Internet business models can create efficiencies for brokers. Rebates are simply the easiest way to return some of that value back to the consumer.

There is no legitimate reason to prohibit rebates.

It is difficult to find a clearly-stated defense for prohibiting consumer rebates. State legislatures and real estate commissions that limit rebates did not act in response to consumer complaints or a principled objection to rebates. Rather, it appears vague "consumer protection" concerns have been invoked and the state authorities rely on the local real estate industry for direction.[6]

The lack of any legitimate consumer protection purpose served by limits on rebates is cited by the U.S. Department of Justice in their action against the Kentucky Real Estate Commission, which asserted that Kentucky Commission rules limiting rebates violate the Sherman Act.[7] Our analysis suggests there is no legitimate consumer protection purpose served by rules limiting rebates.

With regard to consumer protection, a key point is that a rebate is not a kickback. The essence of a kickback is a *secret* agreement. The American Heritage Dictionary defines kickback as a secret payment to a facilitator.[8] A consumer rebate from the real estate commission presents exactly the opposite situation. It is not secret – in fact, the buyer openly bargains for it and seeks it from the broker. Moreover, the rebate *returns* funds to the buyer, the principal, thus lowering, rather than increasing, the cost of the transaction.

Thirty-eight states currently permit consumer rebates and we are not aware of any state with significant reports of consumer confusion or abuse. There is no legitimate evidence of consumers being injured or harmed by the ability to receive a rebate.[9]

The rebate is simply a price reduction – it is structured different to overcome the odd mechanics of the transaction.

Which states limit rebates?

Real Estate Commissions in four states, using strange reasoning, hold that consumers must be licensed as agents in order to obtain a rebate. They reason that when a home buyer receives a rebate, then he or she is being paid as an agent (even though it is for himself or herself). Since acting as an agent requires a license, the consumer must therefore be licensed. The absurdity of this logic is shown by the fact that the homeowner is free to sell his or her home "by owner" without any licensing concerns being raised. States that take this position are Alaska, Louisiana, Mississippi and New Jersey.

In Kansas, Oklahoma, Missouri and West Virginia, the Real Estate Commission interprets statutes that prohibit "inducements" to prohibit rebates.

In Alabama, Oregon, and Tennessee, the Real Estate Commission only permits a rebate if it is done as a credit at closing, which is difficult to arrange because it reduces the nominal sales price of the home and confuses the seller.

One state, Iowa, has a statute that is a rifle-shot at the Internet networks that make local agents and brokers better able to compete and gain market share. Iowa prohibits rebates only where a consumer works with two real estate brokers, which occurs when a local broker partners with an online broker.

Common questions:

1. Isn't real estate brokerage already very competitive, with over one million agents competing?

This argument confuses two concepts. It is one thing for an industry to have many participants, each operating within the tight confines of industry rules and customs. It is quite another thing to unleash agents and brokers to create new and different business models and to permit brokers to offer different bundles of services at prices set by the market.

Competition is impaired if agents and brokers are constrained from using the business model that best suit their market. Permitting brokers and agents to offer consumer rebates would produce better competition with benefits to both professionals and consumers.

2. Isn't prohibition of rebates a state and local matter?

Increasing homeownership is an important policy objective, and policies that impose inflated transaction costs should be scrutinized, regardless of whether they occur at the local, state, or national level.

Like many areas of commerce, real estate brokerage has both local and national aspects. Most people with experience in the industry, including the authors of this paper, believe buying a house should be undertaken with the assistance of a local professional. But the brokerage transaction extends beyond the locality in scope and impact, in many ways.[10]

3. Why doesn't the market work to self-correct?

Many people generally believe antitrust enforcement should be limited because a company that tries to restrain trade will be punished by the marketplace. A misbehaving company's competitors, offering a better product or a better price, will win customers.

But, where industry rules that prevent agents and brokers from using competitive tools, a very different problem exists. Economists and antitrust scholars agree that where common behavior is enforced – by law, industry policy, or by agreement among competitors – the ability of the market to self-correct is impaired because innovators are unable to compete.

4. Why have policies prohibiting rebates survived?

Rules against rebates have largely been hidden from view because the industry has adapted to them. In the states where rebates are not permitted, consumers are not accustomed to the offer, and brokers are not accustomed to offering it. Moreover, real estate purchase and sale is a transaction most consumers undertake only rarely. This defeats momentum to change the law.

Conclusion

Giving consumers a rebate of real estate brokerage fees is, essentially, a form of price competition among brokers. Rebates often cast as a consumer issue, and the benefits to the consumer of lower costs are undeniable: lowering transaction costs lowers the cost of the home.

The key insight we highlight in this paper is that the ability to give rebates helps not only consumers, but it helps agents and brokers by allowing them to better compete. Rebates are a tool an agent or broker can use to differentiate its services, to compete by capitalizing on efficient business methods.

Policies that prevent agents and brokers from using consumer rebates serve the interests of uniformity and conformity in the industry and hold back innovators.

Real estate brokers and agents must be free to adapt and revise and pivot, to select the business model that is right for their situation. There will be many new methods, models, and combinations. Some brokers will operate through main street offices, some will operate from their home, and some will use the Internet as their office (it is not just the "window" of their office). Some brokers will market their own brand name, some will join a franchise, and some will allow agents to individualize. Some brokers will provide all services, soup to nuts, and others will specialize and partner with third parties – including online brokers – to provide select services. There is room in the industry for new models.

Industry leaders and policymakers should embrace the new business methods and lead the way to remove barriers to competition.

[1] Just to illustrate the point, consider a consumer purchasing a book listed for $10.00. He will pay a lower price if: a) the book seller reduces the price to $9.00, or b) the book seller takes the buyer's $10.00 bill and returns $1.00. Either way, $1.00 of value goes back to the buyer and the buyer is paying $9.00, not $10.00.

[2] This summary description does not describe the several models of agency in use in various states. Different agency models are relevant to the nature of the buyer's transaction. For example, in many states the agent working with the buyer, under law, is deemed to be a sub-agent of the home seller. In other states, transactional brokerage creates a different arrangement. Buyers' brokers are also an option. In each case, however, the home buyer selects a broker to work with. We argue that, regardless of the type of agency relationship involved, the ability for the consumer to receive a rebate, and thereby lower the transaction costs of buying a home, is relevant to the buyers' decision of which broker to select.

[3] See www.vistafcu.org for one of many federal credit unions that offer access to a rebate through a network. Also see www.costco.com. USAA, the company that serves the U.S. military community, was an early adopter of a rebate program. See www.USAA.com.

[4] In its complaint filed against the Kentucky Real Estate Commission, the DOJ cites broker concerns with rebates lowering commission fees. U.S. v. Kentucky Real Estate Commission, complaint filed March 31, 2005 (settled July 15, 2005).

[5] RealEstate.com also provides its network of agents and brokers with tools and resources, such as customer management software. And, we provide our network with access to national marketing, which is often inaccessible to many local brokers.

[6] See Report of U.S. Government Accountability Office, *Real Estate Brokerage: Factors That May Affect Price Competition*, August, 2005. GAO also notes that the original intent of many anti-rebate policies was fees paid to third parties, not the principal in the transaction.

[7] See U.S. v. Kentucky Real Estate Commission, complaint filed March 31, 2005 (settled July 15, 2005).

[8] American Heritage Dictionary, Office Edition, 1994. See also Merriam-Webster Online Dictionary, which defines kickback as "a return of a part of a sum received often because of confidential agreement or coercion." www.m-w.com.

[9] Some have speculated that a broker could induce a homeowner to sell a home by offering something of extraordinary value, like a car, in order to list the home with that broker. That is a different concern than is addressed by rules prohibiting rebates. Even if policymakers felt that a broker should not be permitted to offer a homeowner value to obtain the consumer's business, that situation could be directly addressed with a clear prohibition on a broker offering things of significant value to a home owner in order to obtain the listing. Moreover, allowing price competition is not unseemly, but is essential to free enterprise and innovation.

[10] One indicator of the national scope of brokerage is that many brokers are geared to serve consumers moving from one state to another. The relocation market is a significant portion of real estate brokerage. For this group of consumers, and for the brokers who serve them, the ability to obtain price competition should not be relegated to a state or local matter.