



CONSUMER **POLICY**
C E N T E R

HOW PERCENTAGE-BASED COMMISSIONS CAN HARM HOME BUYERS AND SELLERS, AND WHAT THEY CAN DO ABOUT IT

STEPHEN BROBECK

SENIOR FELLOW

MARCH
2025

HOW PERCENTAGE-BASED COMMISSIONS CAN HARM HOME BUYERS AND SELLERS, AND WHAT THEY CAN DO ABOUT IT

The most common way most residential real estate agents are compensated is through commissions representing a percentage of home sale prices. Many commentators have observed that this compensation system rewards agents if home prices increase, regardless of any improvement in agent services or increased agent costs.¹

This report goes beyond this observation to suggest that percentage-based commissions can harm consumers in two specific ways. First, the commissions provide buyer agents with a financial disincentive to negotiate low home sale prices for their clients. While many agents resist this temptation, there is evidence that others succumb to it. Second, the fact that most agent compensation is expressed in percentages, not dollars, leads many home sellers and buyers to underestimate the real dollar cost of commissions. To many for example, 6% of a \$500,000 sale price is perceived to be less costly than \$30,000.

This report explores both issues using available research. It also discusses ways for consumers to minimize related harms that would also improve the efficiency of the residential real estate marketplace.

Buyer Agent Disincentive to Negotiate Down Sale Price

The disincentive for percentage-based commissions to discourage buyer agents from negotiating down home sale prices has been the subject of recent academic research. In a 2024 research report, two Federal Reserve economists discussed the “backward incentive for buyers’ agents.”²

- “This compensation structure gives buyers’ agents a direct disincentive to help their clients locate suitable homes with low asking prices posted by the sellers. Further after a suitable home has been located, the buyer’s agent represents her client in negotiations with the seller over the final transaction price. Here, as well, the harder and smarter the buyer’s agent negotiates on behalf of her client, the less she gets paid at closing.”

¹ For the most thorough discussion of agent compensation, see: Mark S. Nadel, “Obstacles to Price Competition in the Residential Real Estate Brokerage Market” (Berkeley Business Law Journal, 2021) and its referenced sources.

² Borys Grochulski, Zhu Wang, Working Paper Series: Real Estate Commissions and Homebuying (Federal Reserve Bank of Richmond, February 28, 2024), p. 3.

In a 2015 study comparing prices paid by real estate agents buying houses to purchases by individuals, four researchers made the following observation.³

- “What is striking about the buy side is that buyer’s agent receives a percentage of the price as commission. This creates an obvious conflict of interest. The buyer wants to minimize the purchase price and the time the asset stays on the market. The buyer agent, on the other hand, seeks to maximize his expected commission revenue while minimizing the time on the market. Given that the agent receives a small portion of the transaction price as commission, the agent’s goal of maximizing the expected commission will conflict with the buyer’s goal of minimizing the selling price. Since the agent’s effort level is not directly observable and the agent has asymmetric information about the market value of the asset, this divergence can lead to shirking by the agent. As a result, the agent may be motivated to convince the buyer to accept a suboptimal purchase price at the bargaining in order to facilitate a faster sale and obtain a higher commission.

The analysis of home prices paid by agents and individuals found that agents paid approximately four percent less than individuals for the houses they purchased. The authors also noted that this finding was similar to those found by other researchers.⁴

A 2022 report by three researchers suggested that this conflict of interest was minimized by the ability of buyers to switch to another agent.⁵ The report does recognize that a fixed percentage commission system “can result in a misalignment of interest between the buyer and the buying agents.” However, it also attempts to show that this conflict of interest is offset by “the absence of a binding contract” which “creates the risk of losing clients for buying agents.” However, now that buyer contracts are mandatory, this finding appears to be much less relevant.

The author of this report believes that a majority of fiduciary agents will seek to advance the interests of their buyer clients. Yet, as evidenced by research findings cited above, some agents apparently are not able to resist this temptation. It would be desirable to try to minimize or eliminate the temptation.

³ Marcus T. Allen, Jessica Rutherford, Ronald Rutherford, Abdullah Yavas, “Conflicts of Interest in Residential Real Estate Transactions: New Evidence” (American Economic Association paper, December 1, 2015), pp. 8-9.

⁴ R.C. Rutherford, T.M. Springer, A. Yavas, “Conflicts between principals and agents: Evidence from residential brokerage (Journal of Financial Economics, 2005). S. Levitt, C. Syerson, “Market distortions when agents are better informed: The value of information in real estate transactions” (The Review of Economics and Statistics, 2008).

⁵ Lawrence Kryzanowski, Yanting Wu, Tingyu Zhou, “Conflicts of Interest and Agent Heterogeneity in Buyer Brokerage” (Real Estate Economics, November 16, 2022).

Greater Buyer and Seller Acceptance of High Commission Rates

Much has been written about the role of the residential real estate industry in the setting of relatively high and uniform commission rates. Much less has been written about why home buyers and sellers accept these high rates. Researchers have suggested several reasons. They have documented that the industry makes available little information about real estate commissions.⁶ They have also noted that consumers have more important priorities, chiefly the sale price and timing of the sale, especially for those selling one home and buying another at the same time.⁷ This report suggests that an additional factor helps explain consumer acceptance – commission rates are usually expressed as a percentage of the sale price not as a dollar figure, thus minimizing the perception of their cost.

It is intuitively understandable that many people would perceive a four-figure dollar figure as being larger than a single-figure percentage even though the two numbers represent the same quantity. For example, \$30,000 appears much larger than 6% when both represent agent compensation on the sale of a \$500,000 house. Research helps explain this perception.

To begin, some people have a limited understanding of percentages. A United Kingdom government survey, for instance, found that “one in five adults (or 20%) has forgotten how to work out either fractions or percentages.”⁸ This finding did not surprise us because in developing a savings program targeting low- and moderate-income households with less education, we were frequently advised to avoid using percentages in discussing savings accounts and savings accumulations.⁹ According to a marketing professor, “Most people, even highly educated ones, are bad at percentages.”¹⁰

In summarizing much research on the issue, one expert observed: “Despite their advantages, percentages add a layer of abstraction that can depersonalize data. It’s hard to conceptualize percentages and translate them to quantities of real units, especially when the actual quantities are very large.”¹¹ Real estate commissions tend to be relatively

⁶ Stephen Brobeck, *Hidden Real Estate Commissions: Consumer Costs and Improved Transparency* (Consumer Federation of America, October 2019). Panle Jia Barwick, *Maisy Wong, Competition in the real estate brokerage industry: A critical review* (Economic Studies at Brookings, December 2019).

⁷ Nadel, *loc. cit.*, pp. 95-96. Stephen Brobeck, *CFA Comments Submitted at DOJ-FTC Public Workshop on Competition Issues* (June 5, 2018), pp. 3-4.

⁸ Sally Weale, “A fifth of adults have forgotten how to do fractions or percentages” (The Guardian, March 7, 2016).

⁹ Several community and agency leaders working with LMI households made this suggestion in a 2001-04 Ford Foundation-funded project, led by the Consumer Federation of America, to explore ways to encourage personal saving in Cleveland.

¹⁰ Pierre Chandon, “So, You Think Your Customers Understand Percentages?” (Knowledge, March 10, 2015).

¹¹ Drew Skau, *Visualization Architect at Visual.fy published by Rock Content* (<https://rockcontent.com/blog/author/writer>).

large, usually at least \$20,000. A similar point was made by two economists who wrote, “Due to their variety of usages, percentages are difficult to process and understand.”¹²

Specific research illustrates the tendency of many to underestimate prices expressed in percentages.¹³ One investigation set a base price, added an additional cost expressed either as a percentage or dollar figure, then asked which total price seemed less expensive. When the base price was over \$100, a large majority (73%) responded that the price with the percentage figure appeared less costly. Other research compared consumer perceptions of a \$50 discount with a 15% discount. Even though the dollar savings were identical, the \$50 off coupon generated 170% more revenue than the 15% off coupon. The researchers suggested that the finding reflected not only respondent failure to do the math correctly but also respondent desire not to do the math.

One investor added an additional insight that goes beyond the cognitive to the emotive.¹⁴ Consumers want to appear to be losing less money, or for home buyers and sellers, paying less money. The investor commented that an investor friend noted that “sometimes it’s easier to look at the percentage of a drop in money vs the stone-cold dollar amounts.” However the investor added: “Personally, I prefer to see the cold, hard dollar amounts [of financial assets] every single time with both the good and the bad. I need that solid punch in the gut (or emotional high-five) every time I see an update as it keeps me ‘motivated.... There’s no softening a \$100,000 loss or gain like it would be by changing it to a percentage.” In the past, when sellers explicitly paid relatively fixed commissions, they may have preferred to view this expense as 5-6 percent rather than as tens of thousands of dollars, the fee for most house sales.

Recommendations to Home Buyers and Sellers

Most consumers already understand the benefits of dealing with dollar figures and not percentage of sale price. When a national research firm asked a representative sample of 1013 adult Americans – “In a contract to sell or purchase a home, would you prefer the agent’s compensation to be listed as a dollar figure or as a percent of the sale price?” – 55% preferred a dollar figure and only 15% favored percent of sale price. Thirty percent expressed no preference. When the firm asked sample members whether they would

¹² Matthew Fisher, Milica Mormann, “The Off by 100% Bias: The Effects of Percentage Changes Greater than 100% on Magnitude Judgments and Consumer Choice” (Journal of Consumer Research, 2022), p. 2.

¹³ Danny Weathers, Scott D. Swain, Jay P. Carlson, “Why Consumers respond Differently to Absolute Versus Percentage Descriptions of Quantities” (Marketing Letters, May 2012).

¹⁴ J. Money, Percentages vs Numbers (<https://budgetsaresexy.com>, September 9, 2013)

support or oppose a requirement that these commissions also be stated in dollars, 68% supported the requirement and only 13% opposed it. Nineteen percent had no opinion.¹⁵

The report is not proposing that policymakers pursue such a requirement but is offering consumers the following suggestions which incorporate the principle that broker fees should be dealt with in dollars not percentages.

First, home buyers and sellers should always view and discuss agent compensation in terms of dollars, not percentage of sale price. When consumers discuss this compensation with their agent, the agent will almost always talk about percentage of sale price, which now usually ranges from 2.5 to 3.0 percent for each agent. Both buyers and sellers should ask their agent what, given the discussed list price, this percentage represents in dollars. This question will inform the agent that the buyer or seller is concerned about agent fees and, we believe, will encourage agents to negotiate these fees. Most buyer and seller contracts (usually called “agreements”) allow the basic agent fee to be expressed as either a percentage of sale price or as a fixed dollar amount though the fee is almost always expressed just as a percentage.¹⁶

Second, buyers should try to negotiate a fixed dollar fee (called “flat fee”) that does not rise if their agents fail to try negotiating a lower price because it is not in their financial interest to do so. Listing agents have this financial incentive. A flat buyer agent fee will help prevent an increase in home price simply because a listing agent tries to raise the sale price while the buyer agent “shirks” from trying to lower it. Experts have proposed giving buyer agents a financial incentive to lower the sale price, but at present these proposals have not been tested adequately in the marketplace.¹⁷

Third, sellers and buyers should consider working with flat fee brokers as an option. The big benefit is that these brokers usually charge much lower fees than do traditional brokers. However there may also be potential costs, including reduced customer service and broker focus on making a sale rather than negotiating the best deal.¹⁸ In the past, flat fee brokers

¹⁵ Survey conducted on May 29-32, 2024, by Big Village (formerly Opinion Research Corp.) as part of their online caravan. The second question read: “At present in buyer and seller home sale contracts, agent commissions are typically expressed as a percentage of sale price. Would you support or oppose a requirement that these commissions also be stated in dollars?”

¹⁶ Since list and sale prices often vary, in sales where agent compensation is based on a percentage, most contract forms used do not permit both the percentage and dollar figure to be listed. However, it would be helpful to home buyers and sellers when the fee is based on a percentage, for a dollar figure based on the list price to be included. Contracts could include a short sentence after the percentage/fixed price option that reads: “This percentage represents (blank) dollars in terms of the list price.”

¹⁷ See Nadel, *loc. cit.*, pp. 133-134.

¹⁸ A useful discussion of flat fee brokers is found in: Dena Landon, Richard Haddad, “What are The Pros and Cons of Flat Fee Real Estate Brokers” (HomeLight, May 31, 2024).

offered their services only to sellers, who paid the compensation of both their agent and the buyer agent. In the future, as these fees are uncoupled, we expect that these brokers, or new ones, will offer flat fee services to buyers as well.

Now that agent fees are being partially uncoupled, buyers as well as sellers have the opportunity to negotiate them. To the extent these consumers treat the fees as dollars, not percentage of sale price, they should be able to more effectively negotiate the fees. This ability, most experts agree, will not only lower commissions overall but align agent compensation more closely with the services that agents provide.¹⁹ Today, agent compensation bears little relationship to the quantity and quality of the services offered.

¹⁹ Brookings Institute and Cato Institution agree on this point. Barwick, loc. cit., pp. 19-21. Roger P. Alford, Benjamin H. Harris, “Anti-Competition in Buying and Selling Homes (Regulation, Summer 2021).