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Close and consolidate: The new reality of real estate

Guest perspective: Consumers won't continue to subsidize inefficiency

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By [Larry A. Whited](#)

Cendant Corp. -- which owns the Coldwell Banker, Century 21, ERA and Sotheby's real estate brands -- [recently announced](#) plans to close and consolidate offices to slash \$50 million in costs at NRT brokerages in 2006. The bold move points to a new reality in the real estate industry: close and consolidate.

The Internet has shaken the foundation of the real estate business and pricing model like no other change before. There are two forces driving the change that all real estate brokerages today are also facing.

Inefficiency

The first is the inefficiency of the current business model. If you compare the real estate business to the productivity standards of any other industry, the numbers are revealing. A company in the manufacturing sector of our economy must maintain a productivity rate of 75 percent-90 percent or they will be forced to cut capacity/cost or go out of business. (The current situations of Ford and GM serve as a vivid example.)

According to the National Association of Realtors, there were 1.3 million members at the end of 2005. NAR also reports that there were a little over 7 million existing-home sales and 1.3 million new-home sales for a total of 8.3 million homes sold in 2005, or six home sales per agent per year. That averages to one sale per agent every two months. Let's assume that there is a desk in an office for each of those 1.3 million real estate agents, and that a sale takes 40 working hours (one week) from initial contact to closing.

Based on those figures, the average agent/desk is non-productive seven out of eight weeks. That works out to an annualized productivity rate of 13 percent. Show me any other industry that can survive with such a low productivity rate and do it for more than 30 years. The real estate business must cut capacity to survive or they will be replaced. Brokerages need to lose 50 percent-75 percent of the overhead they are currently carrying. Does that mean a reduction in licensed agents or a drastic change in their business practices? The consumer will not continue to subsidize non-productivity.

Pressure comes down on commissions

The second force at work is the downward pressure on the sales commission structure. It had been an average 7 percent commission real estate market for almost 30 years even as home prices increased 300 percent-400 percent in that same time period. Most listing brokers kept 4 percent and gave the cooperating buyer broker a 3 percent "co-op" commission. The 13 percent productivity rate worked as long as homeowners were willing to pay 7 percent sales commission.

That began to change in 2000 with the increased accessibility and power of the Internet. Potential buyers now have listings and information at their fingertips at no cost. Homeowners began demanding a reduced commission, and we have seen the commission rate drop to an average 5 percent today. Now the listing company in most markets keeps only 2 percent and pays the co-op broker a 3 percent co-op fee. Most homeowners want to list with a brand-name company so the large companies had the bulk of the listings, and they have taken a 50 percent reduction in commission income as a result.

The 3 percent co-op fee has been a hard number for more than 40 years and is the only thing propping up the commission rate at 5 percent. You can bet that the large brokers are not going to give more than they make to the



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co-op broker much longer. Prior to the Internet, the listing broker had to offer a 3 percent co-op or other brokers would not show their listings. The buyers relied on their agent to tell them what was for sale and in some cases even pick the homes to show them. Now buyers see all homes for sale on the Internet and give their agent a list of homes they want to see. The agent would not dare say no to the client. They will show clients whatever they want to see regardless of the co-op commission offered. Granted, agents will not try as hard to sell a home with a lower co-op percentage, but buyers decide what they want, not the agent.

It will not be long before large national and regional brokers begin to offer a 2.5 percent co-op and other brokers will follow. Once the 3 percent co-op barrier is broken, a 50/50 commission split will become the new reality among real estate brokers, allowing the commission to continue to shrink.

I predict a 2 percent commission with a 1 percent co-op by the end of this decade or next decade at the latest. The brokers who cut capacity and pass the savings to the consumer will be here next decade. Those who expend funds and energy holding on to the last-century business model will be greatly reduced or disappear. Just ask Ford and GM if that is not possible. This is the new reality of the real estate business.

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