The Effects of Neighborhood Characteristics on Real Estate Brokerage Competition

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Abstract:

In the United States, real estate brokerage firms are predominantly paid a fixed commission rate, such as 5 or 6%, on the sales price of the home after a successful transaction. Thus, on the margin, more expensive homes represent a larger payout for the brokerage firm. This could suggest greater brokerage competition among higher priced homes, with less intense competition among lower priced ones.

An alternative hypothesis could be that barriers to entry are higher in the upper end of the home price distribution and lower in the low end, where new entrants can more easily establish a foothold. These barriers to entry at the high end could come from the reputational status of well-known, existing firms that sellers with more expensive homes gravitate towards.

A small existing literature exists on brokerage competition, but thus far, it appears no work has been done on how competition levels vary by heterogenous geographic submarkets within a larger real estate market. This paper explores the connection between market structure and competitiveness of real estate brokerage services across different sub-areas that vary by average housing price, average income, racial composition, and other demographic factors. Data are drawn from two waves of data collected from a real estate aggregator site across twenty-five large metro areas in the United State.

The hypothesis that lower income areas suffer from less brokerage competition is refuted. Evidence is found, however, that these lower income areas experience more turnover among brokerage firms and are served by firms that are less established in the area.