
Introduction: The Hidden Side of Everything

It is the quintessential blend of commerce and camaraderie: you hire a real-estate agent to sell your home.

She sizes up its charms, snaps some pictures, sets the price, writes a seductive ad, shows the house aggressively, negotiates the offers, and sees the deal through to its end. Sure, it's a lot of work, but she's getting a nice cut. On the sale of a \$300,000 house, a typical 6 percent agent fee yields \$18,000. Eighteen thousand dollars, you say to yourself: that's a lot of money. But you also tell yourself that you never could have sold the house for \$300,000 on your own. The agent knew how to—what's that phrase she used?—"maximize the house's value." She got you top dollar, right?

Right?

A real-estate agent is a different breed of expert than a criminologist, but she is every bit the expert. That is, she knows her field far better than the layman on whose behalf she is acting. She is better informed about the house's value, the state of the housing market, even the buyer's frame of mind. You depend on her for this information. That, in fact, is why you hired an expert.

As the world has grown more specialized, countless such experts have made themselves similarly indispensable. Doctors, lawyers, contractors, stockbrokers, auto mechanics, mortgage brokers, financial planners: they all enjoy a gigantic informational advantage. And they use that advantage to help you, the person who hired them, get exactly what you want for the best price.

Right?

It would be lovely to think so. But experts are human, and humans respond to incentives. How any given expert treats you, therefore, will depend on how that expert's incentives are set up. Sometimes his incentives may work in your favor. For instance: a study of California auto mechanics found they often passed up a small repair bill by letting failing cars pass emissions inspections—the reason being that

FREAKONOMICS

lenient mechanics are rewarded with repeat business. But in a different case, an expert's incentives may work against you. In a medical study, it turned out that obstetricians in areas with declining birth rates are much more likely to perform cesarean-section deliveries than obstetricians in growing areas—suggesting that, when business is tough, doctors try to ring up more expensive procedures.

It is one thing to muse about experts' abusing their position and another to prove it. The best way to do so would be to measure how an expert treats you versus how he performs the same service for himself. Unfortunately a surgeon doesn't operate on himself. Nor is his medical file a matter of public record; neither is an auto mechanic's repair log for his own car.

Real-estate sales, however, are a matter of public record. And real-estate agents often do sell their own homes. A recent set of data covering the sale of nearly 100,000 houses in suburban Chicago shows that more than 3,000 of those houses were owned by the agents themselves.

Before plunging into the data, it helps to ask a question: what is the real-estate agent's incentive when she is selling her own home? Simple: to make the best deal possible. Presumably this is also your incentive when you are selling your home. And so your incentive and the real-estate agent's incentive would seem to be nicely aligned. Her commission, after all, is based on the sale price.

But as incentives go, commissions are tricky. First of all, a 6 percent real-estate commission is typically split between the seller's agent and the buyer's. Each agent then kicks back half of her take to the agency. Which means that only 1.5 percent of the purchase price goes directly into your agent's pocket.

So on the sale of your \$300,000 house, her personal take of the \$18,000 commission is \$4,500. Still not bad, you say. But what if the house was actually worth more than \$300,000? What if, with a little

Introduction: The Hidden Side of Everything

more effort and patience and a few more newspaper ads, she could have sold it for \$310,000? After the commission, that puts an additional \$9,400 in your pocket. But the agent's additional share—her personal 1.5 percent of the extra \$10,000—is a mere \$150. If you earn \$9,400 while she earns only \$150, maybe your incentives aren't aligned after all. (Especially when she's the one paying for the ads and doing all the work.) Is the agent willing to put out all that extra time, money, and energy for just \$150?

There's one way to find out: measure the difference between the sales data for houses that belong to real-estate agents themselves and the houses they sold on behalf of clients. Using the data from the sales of those 100,000 Chicago homes, and controlling for any number of variables—location, age and quality of the house, aesthetics, and so on—it turns out that a real-estate agent keeps her own home on the market an average of ten days longer and sells it for an extra 3-plus percent, or \$10,000 on a \$300,000 house. When she sells her own house, an agent holds out for the best offer; when she sells yours, she pushes you to take the first decent offer that comes along. Like a stockbroker churning commissions, she wants to make deals and make them fast. Why not? Her share of a better offer—\$150—is too puny an incentive to encourage her to do otherwise.

Suffice it to say,
tried to talk one
into taking a low

I have NEVER
of my Sellers
offer! BG

Of all the truisms about politics, one is held to be truer than the rest: money buys elections. Arnold Schwarzenegger, Michael Bloomberg, Jon Corzine—these are but a few recent, dramatic examples of the truism at work. (Disregard for a moment the contrary examples of Howard Dean, Steve Forbes, Michael Huffington, and especially Thomas Golisano, who over the course of three gubernatorial elections in New York spent \$93 million of his own money and won 4 percent, 8 percent, and 14 percent, respectively, of the vote.) Most

FREAKONOMICS

Too bad she sees things differently. A real-estate agent may see you not so much as an ally but as a mark. Think back to the study cited at the beginning of this book, which measured the difference between the sale prices of homes that belonged to real-estate agents themselves and the houses they sold for their clients. The study found that an agent keeps her own house on the market an average ten extra days, waiting for a better offer, and sells it for over 3 percent more than your house—or \$10,000 on the sale of a \$300,000 house. That's \$10,000 going into her pocket that does not go into yours, a nifty profit produced by the abuse of information and a keen understanding of incentives. The problem is that the agent only stands to personally gain an additional \$150 by selling your house for \$10,000 more, which isn't much reward for a lot of extra work. So her job is to convince you that a \$300,000 offer is in fact a very good offer, even a generous one, and that only a fool would refuse it.

This can be tricky. The agent does not want to come right out and call you a fool. So she merely implies it—perhaps by telling you about the much bigger, nicer, newer house down the block that has sat unsold for six months. Here is the agent's main weapon: the conversion of information into fear. Consider this true story, related by John Donohue, a law professor who in 2001 was teaching at Stanford University: "I was just about to buy a house on the Stanford campus," he recalls, "and the seller's agent kept telling me what a good deal I was getting because the market was about to zoom. As soon as I signed the purchase contract, he asked me if I would need an agent to sell my previous Stanford house. I told him that I would probably try to sell without an agent, and he replied, 'John, that might work under normal conditions, but with the market tanking now, you really need the help of a broker.'"

Within five minutes, a zooming market had tanked. Such are the marvels that can be conjured by an agent in search of the next deal.

Consider now another true story of a real-estate agent's informa-

tion abuse. The tale involves K., a close friend of one of this book's authors. K. wanted to buy a house that was listed at \$469,000. He was prepared to offer \$450,000 but he first called the seller's agent and asked her to name the lowest price that she thought the homeowner might accept. The agent promptly scolded K. "You ought to be ashamed of yourself," she said. "That is clearly a violation of real-estate ethics."

K. apologized. The conversation turned to other, more mundane issues. After ten minutes, as the conversation was ending, the agent told K., "Let me say one last thing. My client is willing to sell this house for a lot less than you might think."

Based on this conversation, K. then offered \$425,000 for the house instead of the \$450,000 he had planned to offer. In the end, the seller accepted \$430,000. Thanks to *his own agent's* intervention, the seller lost at least \$20,000. The agent, meanwhile, only lost \$300—a small price to pay to ensure that she would quickly and easily lock up the sale, which netted her a commission of \$6,450.

So a big part of a real-estate agent's job, it would seem, is to persuade the homeowner to sell for less than he would like while at the same time letting potential buyers know that a house can be bought for less than its listing price. To be sure, there are more subtle means of doing so than coming right out and telling the buyer to bid low. The study of real-estate agents cited above also includes data that reveals how agents convey information through the for-sale ads they write. A phrase like "well maintained," for instance, is as full of meaning to an agent as "Mr. Ayak" was to a Klansman; it means that a house is old but not quite falling down. A savvy buyer will know this (or find out for himself once he sees the house), but to the sixty-five-year-old retiree who is selling his house, "well maintained" might sound like a compliment, which is just what the agent intends.

An analysis of the language used in real-estate ads shows that certain words are powerfully correlated with the final sale price of

Five Terms Correlated to a Lower Sales Price

Fantastic
Spacious
!
Charming
Great Neighborhood

Three of the five terms correlated with a higher sales price are physical descriptions of the house itself: granite, Corian, and maple. As information goes, such terms are specific and straightforward—and therefore pretty useful. If you like granite, you might like the house; but even if you don't, "granite" certainly doesn't connote a fixer-upper. Nor does "gourmet" or "state-of-the-art," both of which seem to tell a buyer that a house is, on some level, truly fantastic.

"Fantastic," meanwhile, is a dangerously ambiguous adjective, as is "charming." Both these words seem to be real-estate agent code for a house that doesn't have many specific attributes worth describing. "Spacious" homes, meanwhile, are often decrepit or impractical. "Great neighborhood" signals a buyer that, well, *this* house isn't very nice but others nearby may be. And an exclamation point in a real-estate ad is bad news for sure, a bid to paper over real shortcomings with false enthusiasm.

If you study the words in the ad for a real-estate agent's *own* home, meanwhile, you see that she indeed emphasizes descriptive terms (especially "new," "granite," "maple," and "move-in condition") and avoids empty adjectives (including "wonderful," "immaculate," and the telltale "!"). Then she patiently waits for the best buyer to come along. She might tell this buyer about a house nearby that just sold for \$25,000 *above* the asking price, or another house that is currently the subject of a bidding war. She is careful to exercise every advantage of the information asymmetry she enjoys.

FREAKONOMICS

But like the funeral director and the car salesman and the life-insurance company, the real-estate agent has also seen her advantage eroded by the Internet. After all, anyone selling a home can now get online and gather her own information about sales trends and housing inventory and mortgage rates. The information has been set loose. And recent sales data show the results. Real-estate agents still get a higher price for their own homes than comparable homes owned by their clients, but since the proliferation of real-estate websites, the gap between the two prices has shrunk by a third.

It would be naïve to suppose that people abuse information only when they are acting as experts or agents of commerce. Agents and experts are people too—which suggests that we are likely to abuse information in our personal lives as well, whether by withholding true information or editing the information we choose to put forth. A real-estate agent may wink and nod when she lists a “well-maintained” house, but we each have our equivalent hedges.

Think about how you describe yourself during a job interview versus how you might describe yourself on a first date. (For even more fun, compare that first-date conversation to a conversation with the same person during your tenth year of marriage.) Or think about how you might present yourself if you were going on national television for the first time. What sort of image would you want to project? Perhaps you want to seem clever or kind or good-looking; presumably you *don't* want to come off as cruel or bigoted. During the heyday of the Ku Klux Klan, its members took pride in publicly disparaging anybody who wasn't a conservative white Christian. But public bigotry has since been vastly curtailed. (Stetson Kennedy, now eighty-eight years old, attributes this evolution in some part to his long-ago “Frown Power” campaign.) Even subtle displays of bigotry, if they be-