



THE ULTIMATE BUYER'S GUIDE

TO REAL ESTATE
COMMISSIONS AND
SIGNING A REPRESENTATION
AGREEMENT

Plain English

No legalese

Explains the NAR Settlement

Lays out compensation models

Identifies potential "traps"

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ABOUT THIS GUIDE

HOME SELLERS AND HOME BUYERS ARE MORE CONFUSED THAN EVER.

Buying and selling a home has become so complicated. Particularly if you haven't done so before, you don't know where to start, who to trust, or what to ask.

I have created this guide to help a home buyer with one small (but important) part of the transaction: entering into a contract with a real estate agent.

Once you have found a real estate agent you are comfortable with, you will likely be asked to sign a representation agreement. This is a contract that spells out exactly what your agent will do for you and how much money you will owe them.

You may also have heard that there is a recent legal settlement that is changing the real estate industry. You may have heard that the seller no longer has to pay the buyer's agent and that you are responsible for paying your own agent. Like everything, it's complicated...

In this guide, I have attempted to outline in broad terms how compensation works in real estate transactions. A lot of money is at stake--often tens of thousands of dollars. You want to make sure you're not getting ripped off and that you're not spending more than you have to.



And, by the way, who am I? I'm a law professor who teaches Contracts and is familiar with how the real estate industry works. I have no dog in the fight. I just want to make sure that sellers and buyers understand the forms that they are signing.

I know it's common to just sign contracts without reading them (guilty, as charged!). But when it comes to a commitment to hire an agent, you really should be taking the time to understand what you are signing.

This applies both to your representation agreement AND any agreement for purchase and sale you might enter into (i.e., a contract with a seller to buy a house).

Please do not sign a document without reading it. Pretty please.

HOW COMMISSIONS USED TO WORK



You may have heard that there are a lot of changes in the real estate industry. To understand the changes, you need to understand how things used to work.

Historically, a seller's agent (also called a listing agent) charged the seller a fee that was intended to be shared with the buyer's agent. For example, the listing agent might charge the seller 6%. And when a buyer closed on the transaction, the listing agent would share that 6% equally with the buyer's agent, so that each would get 3%. This is referred to as cooperative compensation.

The amount that would be shared with the buyer's agent was posted on the Multiple Listing Service (MLS) database so that buyers' agents knew ahead of time what amount they would get.

Potential buyers, like yourself, would typically work with buyers' agents without a formal contract in place. Everyone just understood that the seller would cover the buyer's agent's commission once the transaction closed. To the buyer, it sort of seemed like having an agent was free. Even though it seemed that way, a buyer's agent was never free. The buyer ultimately paid for their agent in the form of a higher purchase price because sellers would bake the extra commission into the price of the house.

WHERE WE'RE GOING . . .



Things are changing a bit now because of a big legal settlement. I won't bore you with the details, but basically, the National Association of Realtors (NAR) had agreed to make some changes to the system to make it more competitive. The allegation in the lawsuit was cooperative compensation was anti-competitive and caused buyers and sellers to pay more in commissions than they should have.

One of the biggest changes is that MLSs, the databases that house all the listings, can no longer display offers of compensation from the seller or listing agent to the buyer's agent. Offers of compensation can still be communicated in other ways though (e.g., orally, through a brokerage's website, etc.).

The reason compensation can't be displayed on the MLS is because it was thought to facilitate "steering" -- i.e., buyer's agents would steer their buyers to properties with higher commission. Any seller who did not offer the "going rate" (so to speak) would be penalized by buyers' agents who would point buyers to listings that offered them--the agent--more money.

The other big change which directly affects you is that buyers now need to have a representation agreement in place prior to touring properties. This agreement must spell out how much money the buyer will pay their agent (in the event that the seller chooses not to cover this cost). Requiring buyers to have representation agreements gives them skin in the game. And it makes them aware that they are ultimately responsible for paying their agent's commission.

One final note. As if that weren't complicated enough, the legal settlement I mentioned (sometimes called the "NAR Settlement") technically only applies to NAR members. These are the agents that pay NAR to be able to use the Realtor logo and moniker. Something like 75% of agents are members of NAR, and they are required to comply with the changes. Non-realtors don't have to comply with NAR rules, but are affected by them indirectly. For example, most MLSs will no longer display compensation--this obviously affects realtors and non-realtors alike.

If you are hiring a non-realtor agent, you may not be required to sign an agreement in advance, though I suspect signing an agreement will become standard practice across all agents (and it is actually required by law in some states).

OK, I'M FREAKING OUT ABOUT SIGNING AN AGREEMENT . . .

It is definitely not unreasonable to be nervous about committing yourself to potentially paying a real estate agent. But one way to think about it is that you were paying them anyway--even though you couldn't directly see it. Sellers would just up the price of their house because they knew they would be covering the cost of your agent.

The representation agreement that you sign will say something to the effect of:

“Buyer agrees to pay a fee of 3%. Agent will try to get this money first from the seller. If the seller does not agree to pay the full 3%, then buyer will pay the difference.”

So, for example, if the seller agrees to pay 2% and your contract says you owe your agent 3%, then you owe that extra 1% “out of pocket.” Hmmm . . . where am I going to get that 1%?

Simple: You could ask the seller in your offer to give you a “concession.” Say the house is listed for \$300,000. You could put in an offer for \$303,000 and ask for \$3,000 back (1%). If the seller agrees, you can then use that money to pay your agent.

The thing to remember is that you are in the driver's seat. You can work with your agent to make offers that give you that extra monetary buffer you need to pay your agent.

But it's also important to negotiate the best rate you can with your agent--the lower the rate, the better your bargaining position.

COMMISSIONS ARE NEGOTIABLE . . . SORT OF

Brokerages are required to say that commissions are not set by law and that they are fully negotiable. This statement, while technically accurate, is a little misleading.

What is true is that the law does not dictate the commission rate. Commissions, for instance, are not like a state sales tax.

But, when brokerages say that commissions “are fully negotiable” that doesn’t mean they are obligated to negotiate them with you. Kind of sneaky, huh?

So any given buyer’s agent might say “My fee is 3%. It’s my brokerage firm’s policy not to do anything lower than that.” It is their right to do that.

If you encounter an agent that won’t budge on their commission, shop around. That’s what an open marketplace is all about.

Also know that alternative compensation models are likely to spring up (hourly fees, flat-rate fees, etc.). Seek out these options if they are a better fit for you.



UNDERSTANDING DIFFERENT MODELS OF COMMISSIONS

MODEL 1: THE TRADITIONAL MODEL

SELLER AGREES TO A LISTING COMMISSION THAT ENCOMPASSES THE AMOUNT TO BE SHARED WITH A BUYER'S AGENT. IF YOU HAVE A SELLER THAT HAS AGREED TO THIS, YOU WILL KNOW IN ADVANCE WHAT IS BEING OFFERED TO YOUR AGENT AND YOU CAN PLAN ACCORDINGLY.

MODEL 2: THE SPLIT MODEL

SELLER AGREES TO TWO SEPARATE COMMISSIONS IN THE LISTING AGREEMENT. SELLER AGREES ON WHAT TO PAY THEIR INDIVIDUAL BROKER. AND THEY SEPARATELY AGREE WHAT THEY WILL PAY THE BUYER'S BROKER. IF YOU HAVE A SELLER THAT HAS AGREED TO THIS, YOU WILL KNOW IN ADVANCE WHAT IS BEING OFFERED TO YOUR AGENT AND YOU CAN PLAN ACCORDINGLY.

MODEL 3: THE PAY-YOUR-OWN-BROKER MODEL

SELLER AGREES IN THE LISTING AGREEMENT ONLY TO PAY THEIR OWN BROKER. HERE, YOU WILL NOT NECESSARILY KNOW IN ADVANCE WHETHER THE SELLER WILL "COVER" THE COST OF YOUR AGENT. YOU NEED TO ASK FOR THAT MONEY THROUGH THE OFFER.

Important Note: Model 3 is the model that the Department of Justice would like to see implemented and the only model that that is pro-competitive and results in lower commissions for consumers overall. A number of brokerages are embracing this model; but change is slow. Do not shy away from properties where you don't know what the seller may be willing to pay--negotiate!! That's why you hired an agent, after all.

BUT, THERE'S MORE!



SOME BROKERAGES ARE DOING "TOURING" OR "SHOWING" AGREEMENTS

Some brokerages have realized that buyers are nervous about signing anything that commits them to a long-term relationship with an agent and to potentially paying for those agent's services. So they have created short-term contracts (sometimes called "touring" or "showing" agreements). These agreements can be structured in different ways. For instance, some touring agreements say that you can tour with an agent at zero cost for some period of time (e.g., one week). Other agreements might be limited to touring one particular house. What they have in common is that they are not a full-fledged representation agreement where you commit to one agent for a period of time.

These agreements are sort of new and it's not clear how they will shake out. Most of them are structured with the expectation that if you want to submit an offer on a property that you viewed under the touring agreement, you will enter into a separate representation agreement which details the commission rate.

Legally speaking, I'm not sure the touring agreement can bind to you agreeing to a separate agreement. The better practice is to have the initial touring agreement specify how much you would owe if you decided to purchase the particular property you toured.

Touring agreements might be a good way to get to know an agent before fully committing.

SNEAKY THINGS TO BE AWARE OF

WHERE THERE'S MONEY . . .

The representation agreement you have with your agent must clearly spell out how much compensation they will get. It cannot be a range or open-ended. It will usually be expressed as a percentage of the purchase price.

Here's a super-duper important point: Under the Settlement, your realtor cannot collect more than the amount that is specified in your agreement, even if the seller is offering more!

Example: Your agreement says your agent will get 2%. A seller is offering 3%. Your agent can only get 2%.

OK, got it.

Yeah, well, the thing is that some agents will try to get you to sign a "modification" agreement so that they can pocket the extra money. They might call this something else, like an addendum or an amendment. Or they might even suggest you re-sign your original agreement with the higher commission percentage. Do not do this!

That money either belongs to you or the seller--not the agent. This is just a way that they are trying to go around the NAR Settlement.



I realize it's icky not to throw your agent a bone--especially when it's "other people's money." But this is how commissions remain high for both home buyers and home sellers.

THE SAME THING APPLIES TO "BONUSES" OFFERED TO BUYER'S AGENTS (IT'S ALL THE SAME THING, JUST A DIFFERENT NAME). DO NOT MODIFY YOUR AGREEMENT TO ALLOW FOR AN AGENT BONUS. SCHEMES LIKE THIS JUST ARTIFICIALLY INFLATE THE AMOUNT CONSUMERS PAY FOR SERVICES.



UNDERSTAND THE FINE PRINT

THERE ARE A NUMBER OF OTHER ASPECTS TO THESE FORMS AND INDUSTRY PRACTICES THAT YOU MAY BE SURPRISED BY.

You May Owe Full Commission Even If You Don't End Up Buying (Closing On) the House

Almost no one knows this. But 99% of these contracts are drafted so that a buyer owes their agent's commission if the buyer goes under contract and then defaults on the purchase agreement. Most buyers understand that if you are "under contract" and you breach the contract (that is, refuse to go forward without a legally valid reason), you will likely forfeit your earnest money deposit. This is usually a large number, sometimes in the tens of thousands of dollars. In addition, you will *also* legally owe your broker the full commission. In other words, if you breach a contract to purchase real estate (which happens more than you would think) you face a double whammy: losing your deposit and paying your agent a full commission. Agents will tell you that they won't go after you if something like that happens, but their word doesn't mean anything. If it's in the contract, they have a right to go after you for it.

You May Be Tricked into Signing a Representation Agreement

The new rules around representation agreements are confusing not just for buyers but for agents as well. Some agents don't fully understand when an agreement is required. Other agents are looking to capitalize on this new requirement to get more business. Because of these things, you might be duped into signing a representation agreement without realizing what you are signing. This has already started to happen. Do not sign anything you haven't read. And do not sign anything at an open house (other than a sign in sheet, if you wish).

You May Be Told Things That Are Flat Out Wrong

If it sounds fishy, it's probably fishy. With all the confusion out there, agents may be misinforming consumers. You may be told, for instance, that you are required to have an agent represent you. This is not true. You may be told that you can't see an open house unless you sign something at the open house. This is not true. You may be told that offers made on a form other than one provided to you by an agent are "invalid" or "not legal." This is not true. There is a lot of misinformation out there.

You May Be Told “Not To Worry” About Certain Things or that Your Agent Will “Waive” Commission

Do not rely on oral or written promises from your agent outside the agreement. Because of a clause in the contract (the “Entire Agreement” clause), these statements will not be allowed in court or in arbitration. For example, it may become common practice for buyer’s agents to charge 3% commission and then tell clients that they will waive any amount not paid by the seller. Even though you may trust your agent to do right by you, realize that none of these promises matter. You signed what you signed and you will be on the hook for the amount you agreed to.

Your Agent May Try to Upcharge if You Want to Buy a For Sale By Owner (FSBO) Property

Your agent might try to charge you extra if you want to buy a house that is for sale by owner (FSBO). This is because they think that it is more difficult to deal with an unrepresented seller. To compensate for this additional difficulty, they will charge you more. Consider whether you are comfortable with this arrangement. If you do agree to pay extra, be sure you evaluate what you think that extra work is worth. I would recommend expressing the additional fee as a dollar amount, not a percentage.

Your Agent May Try to Charge Junk Fees

A number of brokerages have started charging small fees (less than \$1000) in addition to charging commission based upon the sales price. It is commonly recognized that these are junk fees and it is strongly suggested that you do not agree to pay them.

Your Contract May Limit Your Right to Sue In Court

Many standard forms now require mediation of disputes. If that fails, then you will arbitrate disputes. This means that you cannot bring a lawsuit in court.

Your Agent May Be Getting Kickbacks

It is common for agents to have referral networks -- e.g., inspectors, mortgage brokers, title companies, lawyers. In a lot of cases, your agent will be getting a referral fee from these providers. Consider this as you decide what outside professionals you would like to engage.



DO I NEED AN AGENT?

I CAN'T ANSWER THAT FOR YOU. BUT IT IS NOT A LEGAL REQUIREMENT THAT YOU HAVE AN AGENT.

You are not legally required to have an agent represent you. You could represent yourself (which is called being an "unrepresented buyer") or you could hire an attorney to help you with the process.

The real estate industry will try to scare you into not being an unrepresented buyer. "You get what you pay for" is a common expression you will hear.

Being an unrepresented buyer is not for everyone. It requires some know-how and there is a learning curve. You will need to find an inspector, a lender, and an attorney all on your own. You will need to keep track of documents. And you will not have professional advice on market conditions and strategy.

But representing yourself is not impossible and people do it all the time. If you are willing to put in the time and effort, it may be an option for you.

But be advised: Listing agents do NOT like dealing with unrepresented buyers. They often refer to them in negative terms. The common refrain is that unrepresented buyers require a lot of "hand holding."



**“Listing agents
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like dealing
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Because of this, some listing agents make life hard for unrepresented buyers. They may refuse to show them the seller's listing and tell them that they "need" an agent to view it. They may refuse to pass along offers from an unrepresented buyer. They may tell these buyers that the offer needs to be on a specific form (not true) and then refuse to give the buyer that form unless they agree to let the listing agent represent them. The listing agent may try to scare unrepresented buyers into getting representation. They may "require" an unrepresented buyer to sign a form saying that they are proceeding against the agent's advice (a listing agent you can't require an unrepresented buyer to sign anything).

I'm not making this stuff up. One form I've seen has caution emojis and **"ATTENTION BUYER"** in bold font emblazoned at the top of the page. It then says **"You have been advised ... to retain a broker[.] Despite this advice, you have elected NOT to work with a buyer's broker."** Notice the scary bold, underline, and all caps.

PARTING WORDS . . .

Talking about money--especially with someone you are about to hire--is always awkward. And real estate agents did themselves a real favor when they decided to talk in percentages instead of actual dollars. Agreeing to pay 3% doesn't sound as scary as agreeing to pay \$20,000.

But even though we talk about these numbers in percentages, at the end of the day, you are paying the commission in real dollars. Dollars that could otherwise have gone in your pocket. So really evaluate how much the services of the buyer's agent you are considering working with are worth to you.

If the buyer's agent you've chosen won't accommodate a commission that is acceptable to you, find another agent. There are millions of them out there! Or, God forbid, consider being unrepresented! Be mindful, though, that being unrepresented is not for the faint of heart.

When it comes to the substantive provisions of the buyer representation agreement, tell your agent if there is something you do not agree with and that you want to take it out. For example, you may only be comfortable committing to paying a commission in the event that a closing actually takes place. Your agent will probably tell you they "can't" change the terms. This is not true. They (or their supervising broker) can change the terms. But they may not be comfortable doing so because the forms were "lawyer approved" and they are scared to do anything wrong. They may assure you that none of these bad things you're thinking of will happen and that they won't go after you if they do. Remember, none of that outside-the-contract stuff matters. You are bound to what you sign in the contract.

After all of this, I hope I didn't scare you. The lawyer in me needs to explain every possibility, even the unlikely ones. Forewarned is forearmed.

Happy house hunting!

This guide is intended to provide an overview of buyer representation agreements that buyers are expected to sign in order to engage the services of a realtor or real estate agent. It does not constitute legal advice and is intended only for general information purposes. If you have questions or concerns about any specific buyer representation agreement, please contact an attorney in your state.

