



THE ULTIMATE SELLER'S GUIDE

TO REAL ESTATE
COMMISSIONS AND
SIGNING A LISTING
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 seller with one small (but important) part of the transacting: entering into a contract with a listing agent.

Once you have found a real estate agent you are comfortable with, you will be asked to sign a listing 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. 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 pay so much money, you really need to take the time to read and understand the contract.

This applies both to your listing agreement AND any agreement for purchase and sale you might enter into (i.e., a contract with a buyer for your 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.

On the buy-side, buyers would typically work with 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.

NOW THERE ARE SEVERAL 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 THE BUYER COMES UNREPRESENTED (NO AGENT), THE LISTING AGENT POCKETS THE ENTIRE COMMISSION.

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.

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

SELLER AGREES IN THE LISTING AGREEMENT ONLY TO PAY THEIR OWN BROKER. IF BUYER WANTS TO ASK FOR FUNDS TO PAY THEIR AGENT, THEY CAN ASK FOR THEM IN THE OFFER AND THE SELLER CAN THEN DECIDE WHAT TO DO.

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. I recommend that you find a broker that will only charge you for *their services* (Model 3) and not require you to agree in advance to pay the buyer's agent.

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 you might go to one brokerage that says “We charge 6%” and they won’t budge off of that number. It is their right to do that.

When you are shopping for a real estate agent, be aware of the three different commission structures. If you absolutely do not want to pay more than your side of the commission, you need to find a brokerage that agrees to Model 2 or Model 3.



PROS AND CONS

TO EACH MODEL

MODEL ONE

Listing agents like this model. It is how they have been doing business their whole career. From the listing agent's perspective, it is way easier to sell your home if you dangle a 3% carrot in front of a buyer's agent. And if a buyer comes to the table unrepresented, the listing agent will usually pocket the full amount (bonus for them!).

The downside from a seller's perspective is that you've pre-agreed to pay thousands of dollars to a buyer's agent even though you are not sure that was necessary. This model could result in you overpaying.

MODEL TWO

Listing agents would probably be ok with this model as well. And they will probably tell you that you need to offer at least 2% or 2.5% commission to incentivize buyers' agents to take their buyers to see the house. Offering buy-side commission obviously makes the listing agent's job easier.

The downside, again, is that you are pre-agreeing to paying thousands of dollars to a buyer's agent even though you are not sure that was necessary. This model could result in you overpaying.

MODEL THREE

Listing agents do not like Model Three because you only pre-agree to pay the listing agent's commission, not the buyer's agent's commission. This makes the listing agent's job harder.

The upside is obviously that you could save approximately 3%. The downside is that some buyers may be nervous about seeing houses or putting offers in on houses where they don't know for sure what the buyer's agent's compensation will be. With that said, signaling that you are willing to consider concessions should be sufficient to ensure that buyers are not steered away from your property.

SNEAKY THINGS TO LOOK OUT FOR



These models are a simplified representation of what brokerages will be doing. There are at least three additional things that you have to be aware of, depending on which model of commissions is being followed:

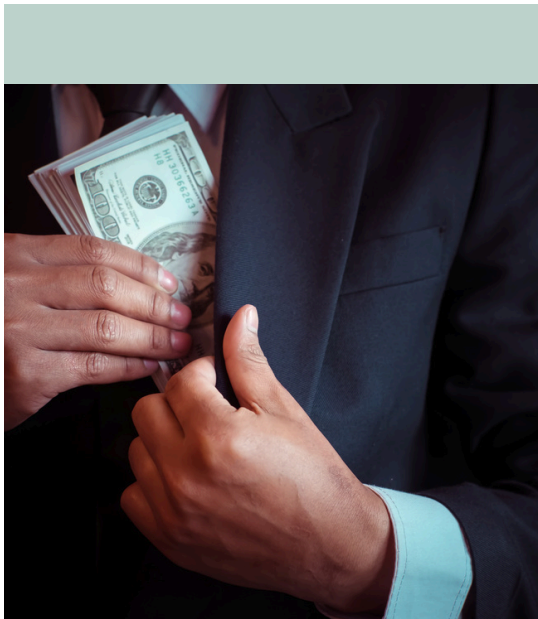
1. Charging Extra for an Unrepresented Buyer

In scenarios where the listing agent charges for their commission only (or separates out commission for the buyer's agent), the listing agent may try to charge you extra depending on whether the buyer has an agent or not.

If the buyer is unrepresented, some contracts require you (the seller) to pay the listing agent an extra fee on top of whatever commission you've already agreed to pay them. For example, you might have agreed to pay your agent 3%. And then they ask you to pay an extra 1% (for a total of 4%) if a buyer comes unrepresented.

The thinking is that it is harder for a listing agent to deal with an unrepresented buyer because they may need more hand holding. This may or may not be true depending on who the unrepresented buyer is.

But bear in mind that this extra fee the listing agent is trying to charge you is just for *administrative work* such as emailing forms to the buyer and coordinating the moving pieces of the transaction. Ask yourself how much this administrative work is worth in dollar terms to you. Do not think of it in terms of percentages. In my view, anything more than \$1000 or so to do some paperwork seems a little on the high side.



SNEAKY THINGS TO LOOK OUT FOR

2. Having Any Excess Commission Go to the Listing Agent

There is a new requirement imposed by the NAR Settlement that buyers need to have their own written contracts with their own agent. This contract needs to specify how much a buyer will owe their agent (in case it's not covered by the seller).

Importantly, the rules now say that the buyer's agent cannot receive *more* than what they agreed to in their contract with the buyer.

For example, if the buyer's agreement with their agent says the agent gets 2% and you (the seller) are offering 3%, the buyer's agent can only get 2%.

So what happens to the extra 1% (which is usually thousands of dollars)? In your listing agreement, you should specify that that money *comes back to you*. It should not go to your agent.

You agreed to pay your agent a set amount of money (say, 3%). Your agent should not now get 4% by scooping up money that was originally intended for a buyer's agent.

Be sure that your contract does not allow this money to go to the listing agent. Any listing agent that tries to get you to give that money to them is not worth hiring.



SNEAKY THINGS TO LOOK OUT FOR

3. Not Giving You a Discount for Dual Agency

A number of states allow an agent to represent both sides in the transaction with the parties' permission. This is referred to as dual agency. It's not ideal from either the buyer or the seller's perspective, though it is sometimes done. Dual agency means that your interests are not really represented because "your" agent is simultaneously working both sides.

In your listing agreement, there will be something that deals with how the listing agent gets paid in cases of dual agency.

Most agents will want to collect full commission from both sides. So, for instance, if you agreed to 3% for the listing agent and 3% for the buyer's agent, your agent will want to collect 6%.

In cases of dual agency, it is common for the listing agent to give you a discount. Instead of the full 6%, they might agree to 5% or 4.5%. Be sure this is addressed in the listing agreement you sign. Otherwise, you are paying full freight for a less-than-ideal representation scenario.



OTHER THINGS YOU SHOULD KNOW

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

You May Owe Commission Even If You Don't Complete The Sale

You may be surprised to learn that you may owe your agent's commission even if you don't ultimately sell your home. Some listing agreements specify that commission is due when the agent finds a buyer "ready, willing and able" to purchase the home. And almost all listing agreements say that commission is owed if you "default" on the purchase and sale agreement. In other words, if you are under contract with a buyer and something happens and you terminate that contract without a valid legal reason, you will owe your agent their full commission.

Your Agent Might "Outsource" Your Open House

It is an open secret in the industry that open houses are used for agents to get buyer clients. Your agent may choose to have someone else at their brokerage (or, get this, at another brokerage!) host your open house. This is not usually addressed in the listing agreement. But be sure that if your agent is hosting an open house, it is your agent (and only your agent) that is there.

Your Agent Might Turn Away Buyers

Some listing agents do not like to bother with unrepresented buyers (i.e., a buyer who does not have an agent). A listing agent might choose not to show the property to an unrepresented buyer or to facilitate any offers from an unrepresented buyer. This goes against their responsibilities to you, the home seller. But, it happens. Be sure to make clear what your expectations are with respect to unrepresented buyers.

Your Agent Might Be Getting Kickbacks

It is common for agents to have referral networks -- e.g., inspectors, stagers, etc. 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.

OTHER THINGS YOU SHOULD KNOW

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

Concessions Are Voluntary and Up to the Seller

Many of the standard forms have a blank space to document the seller's willingness to consider concessions. "Concessions" means money back to the buyer for things that need to be done to the house or for expenses that the buyer will incur in the purchase process (e.g. lawyers, inspectors, etc.). Remember, this is simply a "willingness" -- you are not bound to follow through on the number that you put there. Do not let anyone tell you otherwise.

Your Agent Might Try to Scare You Into Paying Buyer Side Commission

Many listing agents will falsely tell their seller clients that if they do not offer buyer agent compensation in advance, then no one will come to their property and they will have a difficult time selling their house. Do not be scared into pre-offering commission because of this statement. Realize that the listing agent has a vested interest in you offering to compensate the buyer's broker because it makes selling easier for them. Decide what is best for you and your situation.

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.

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 5% doesn't sound as scary as agreeing to \$30,000.

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 consider how much you think the services of a listing agent you are considering is worth in your particular scenario. Also consider what you are comfortable doing on the buyer-side. Some brokerages will (essentially) require you to pay buyer-side commissions if you want to hire them; others won't. Figure out strategically what is best for you.

If the listing agent you've chosen won't accommodate what you want to do, find another agent. There are millions of them out there! Or, God forbid, go at it alone or with an attorney!

When it comes to the substantive provisions of the listing agreement, tell your agent if there is something you do not agree with and 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 (i.e., you've sold the house). I will almost guarantee you that your listing agreement does not say that, but instead says commission is owed in other circumstances as well.

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 stuff is admissible--you are bound to what you sign in the contract. If they won't change it, which they may not, then just realize that there are some not-so-great things in the contract to be aware of.

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 selling!

This guide is intended to provide an overview of listing agreements that sellers 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 listing agreement, please contact an attorney in your state.

