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The Way Real Estate Agents Are Compensated Confuses Many Buyers & Sellers

REAL ESTATE TODAY

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The real estate industry is unlike any other industry in the way its sales personnel are compensated. Since it is a persistent source of confusion for the general public, allow me to explain.

Imagine you went to a Ford dealership and described what you need in a car or truck. The salesman goes to his computer and pulls up his own inventory and the inventory of all the other dealers in the metro area.

It turns out that Chevrolet or Toyota might have a vehicle that better fits your needs, and the salesman knows that he'll earn just as much by taking you to their lots and selling you one of their vehicles, so you get in his Tesla and go car-hunting. He even takes you for test drives without a salesman from the other dealership being involved at all. You go back to the Ford dealership, where a purchase offer is signed and emailed to the dealership which has that vehicle. The salesman helps you arrange financing with a trusted lender and sends proof of cash or financing with the offer.

Although there are some "auto brokers" who function as I've described above (in fact, I bought my Chevy Volt using an auto broker), that's ***not*** how most car sales transactions work. It is, however, ***exactly*** how real estate works.

You've probably heard of the Multi-List Service (MLS) on which real estate listings are posted. The central premise of the MLS is "cooperation and compensation." To be a member of the MLS — essential if you're in the real estate business — ***you must agree to cooperate*** with every other member of the MLS and to ***offer compensation*** if another member sells your listing. The percentage commission offered to other members is called the "co-op" commission. In the Denver market, that commission is typically 2.8%. There's an interesting history of MLS-type "exchanges" dating back as far as the 1880's, which you can read at **www.NAR.realtor** or by googling MLS.

The listing contract which every agent prepares for a seller specifies the ***total*** commission (typically between 5 and 6 percent) and the ***co-op*** which he or she is offering to other MLS members. In the "old days," before Taft-Hartley antitrust laws were enforced in our industry, the Denver Board of Realtors prescribed a 7% listing commission, and prescribed that 40% of that commission (or 2.8%) be offered to other agents as a co-op. Under that formula, sellers would pay 4.2% commission to the listing agent and 2.8% to the selling agent at closing.

Once the Department of Justice said that antitrust laws apply to the real estate industry, the Board of Realtors and the MLS could no longer dictate commission rates, and listing rates began their inevitable decline as agents competed with each other for listings. This is a good thing for sellers, but it has no real meaning for buyers. Indeed, when listing agents have tried to pay less than 2.8% co-op commission, they have found that buyers' agents are less likely to show and sell their listings. As a result, listing agents now earn less than buyers' agents in a given transaction, even though they are the ones laying out money for photographs, brochures, staging consultations, advertising and other expenses associated with maximizing their listings' exposure to potential buyers.

Now and then, this commission model — wherein the entire commission is paid by the seller — is challenged, but it endures almost universally, if for no other reason than "it works."

Where this business model causes confusion is when a broker or brokerage advertises a 1% or 2% "listing fee" in order to get a listing appointment, at which time the seller learns that this does not include the requisite (or at least recommended) 2.8% commission to the buyer's agent.. These brokers and brokerages know that advertising a 3.8% or 4.8% listing fee would garner them far fewer listing appointments.

Another source of confusion is what's known as the ***variable commission.*** This term applies to a commission that is reduced if the listing agent doesn't have to pay a co-op commission because the buyer has no agent of his own. However, most listing agents — 85% by my calculation — don't mention reducing their commission in their listing presentations and hope that the seller won't ask them about reducing their commission if they don't have to pay a co-op commission. At Golden Real Estate, it is office policy to offer a variable commission.

As real estate values continue to increase, it's reasonable to ask whether the commission rates — which I've said is typically between 5 and 6 percent) should be reduced on the theory that it takes little more money and work to market a million-dollar home than it does to market a $400,000 or $500,000 home.

The extent to which listing agents can reduce their commission, however, is limited by that 2.8% co-op commission that we feel obligated to offer. After all, if, for example, we reduced our commission to 4%, we'd only earn 1.2% after giving away 2.8% to the buyer's agent.

Where we can be more accommodating on those higher priced homes is in agreeing to a lower variable commission. My practice is to reduce my 5.6% commission to 4.6% when I don't have to pay 2.8% to a buyer's agent, but I'm willing to adjust both those numbers on a higher-priced listing. By the way, that appears to be the practice of most broker associates at Golden Real Estate. Because of Taft-Hartley, I can't dictate what they offer.

About 5% of transactions are double-ended, although that percentage is much higher with us because of our more extensive marketing of listings and the fact that we offer ***Totally Free Moving*** to unrepresented local buyers of our listings.

Another Area of Confusion: When Is Your Real Estate Agent a 'Transaction Broker' and Not an 'Agent'?

Although it's common (including by me) to talk about real estate professionals as "agents," the proper term is "brokers," because the term "agent," at least here in Colorado, has a specific legal meaning which is important to understand.

One reason most of us call each other "agents" instead of "brokers" is that here in Colorado the term "broker" is commonly used when referring to the employing broker or managing broker in a real estate company. For example, I'm the "broker" at Golden Real Estate, and my agents are "broker associates." It's just simpler (and more common) to call them "agents."

So what is an "agent" in the ***legal*** sense? An agent is an ***advocate*** for his or her client, serving with "the utmost good faith, loyalty and fidelity." An agent will share with his client anything that helps in negotiating the best deal in a transaction. For example, if a broker were to reveal that his buyer is desperate to buy a home or that his seller is desperate to sell his home, an "agent" on the other side of the transaction could (and should) use that information to his client's advantage. A good "agent" would ***never*** let that kind of information slip!

A "transaction broker" has no such responsibility to his or her client and functions only to facilitate a transaction. Indeed, he is barred from disclosing to one party anything about the other party that would favor that party in negotiating a transaction.

At Golden Real Estate, as at most brokerages, it is our office policy to always function as "agents" for our buyers and sellers. The only exception is when we find ourselves on both sides of a transaction because one of our preexisting buyer clients (for whom we're an agent) wants to buy a property from one of our sellers (for whom we're also an agent). Then we're obligated to serve as a transaction broker and advise each party that we're now a neutral facilitator of the transaction and can no longer coach either party regarding price or any other transaction issue.

So what happens when an unrepresented buyer approaches a listing agent about buying his or her listing for which he is functioning as an "agent"? The agent ***could*** choose to have the buyer sign an agency agreement, but that would require him to sacrifice his "agent" relationship with the seller and become a transaction broker. It is Golden Real Estate's policy always to treat an unrepresented buyer of our listings as a "customer," thereby retaining our "agent" relationship with the seller.

Did I confuse you more? I hope not! Hopefully the broker you employ knows the rules of agency relationship, as we certainly do.

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